DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR LATVIA

As approved by the Board of Directors at its meeting on 9 September 2008

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ABBREVIATIONS

ATS	Assessment of Transition Challenges
BAS	Business Advisory Services
BIP	Baltic Investment Programme
BTAF	Baltic Technical Assistance Fund
CIS	Commonwealth of Independent States
CPI	Corruption Perceptions Index
CRR 3	Capital Resources Review 3
EC	European Commission
EIB	European Investment Bank
ERDF	European Regional Development Fund
ETC	Emissions Trading System
EU	European Union
EUR	Euro
GDP	Gross Domestic Product
FI	Financial Institutions
FIML	Financial Instruments Market Law
IFC	International Finance Corporation
IFI	International Financial Institutions
ILO	International Labour Organization
IMF	International Monetary Fund
IOSCO	International Organisation of Securities Commissions
IPO	Initial Public Offering
IT	Information Technology
KfW	Kreditanstalt für Wiederaufbau
LIS	Legal Indicator Survey
LPP/LC	First Party-Latvia's Way
LVL	Latvian Lats
MEI	Municipal and Environmental Infrastructure
MiFiD	Market in Financial Instruments Directive
MNP	Mobile Number Portability
MSME	Municipal and Small and Medium Enterprises
MVNO	Mobile Virtual Network Operator
NBFI	Non Bank Financial Institution
NEPP	National Environmental Policy Plan
NGO	Non Governmental Organisation
NIB	Nordic Investment Bank
NSRF	National Strategic Reference Framework
OECD	Organization for Economic Co-operation and Development
OP	Operational Programme
PPP	Public Private Partnership
RPC	Riga Psychiatric Clinic
RTD	Research and Technology Development
SAMS	Bank of Latvia's interbank automated payment system
SME	Small and Medium Enterprises
SPRK	Public Utilities Commission

TAM	Turn Around Management Group
TB-LNNK	Fatherland and Freedom/LNNK
TC	Technical Cooperation
TVPA	Trafficking Victims Protection Act
UNDP	United Nations Development Programme
US$	United States Dollar
VNIA	Valsts Nekustama Ipasuma Agentura
WHO	World Health Organisation
WTO	World Trade Organisation

EXECUTIVE SUMMARY

The Republic of Latvia continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. Since the start of its transition Latvia has made substantial progress in structural reforms and by now some 70 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.

At the same time, the current macroeconomic environment poses serious challenges. Following three years of double-digit growth rates, the economy has started to slow down significantly. This slowdown is primarily related to a rapid moderation in domestic demand, reflecting measures by banks and the government to tighten credit growth and rising inflation. Both private consumption and residential investment have grown at very high rates in recent years, leading to an excessive current account deficit and rising inflationary pressures. While the current account deficit, standing at close to 23 per cent of GDP in 2007, is expected to narrow, inflation (16.7 per cent in July 2008) is likely to remain high in 2008 as supply factors continue to push up prices. The economy consequently remains vulnerable to financial crisis, in particular if the exchange rate framework is affected, and to changes in external competitiveness.

In the last two years, the government has made some progress on the reform agenda. The authorities have stepped up efforts designed to improve the business climate, fight corruption and improve transparency. The liberalisation of the power sector has largely been completed and efforts are now focussed on ensuring sufficient energy supply and increasing energy efficiency. There has also been significant progress in restructuring the railways. In the banking sector, recent efforts have focussed on moderating credit growth, improving the implementation of regulation, financial sector supervision, and implementing anti-money laundering legislation.

In the current environment the main objective of the government is to secure macroeconomic stability and move forward on the structural reform agenda. The key transition challenges for Latvia include:

- **Ensure long-term competitiveness**, especially in light of high wage pressures and a tight labour market. The situation in the labour market is gradually easing, though wage pressures remain. Further steps will be needed to improve the business environment and ensure productivity-enhancing investments.
- **Support the further development of financial intermediation,** mainly for SMEs through equity and mezzanine capital, and improve corporate governance and business practices in selected banks.
- Promote sufficient **alternative energy supply, energy efficiency and renewable energy** in order to enhance energy security, reduce energy intensity and meet environmental targets. The anticipated closure of the Ignalina power plant in 2009 adds urgency to this challenge.
- **Modernise municipal and environmental infrastructure** with the assistance of EU structural and cohesion funds, private sector involvement and commercial co-financing from local sources. This will require the strengthening of municipal administrative capacity and cooperation, particularly among smaller

municipalities, as well as improvements in procurement and project management standards.

By the end of July 2008 the Bank had committed EUR 327 million which attracted a further EUR 897 million from sponsors and co-financiers.

The Bank's priorities in Latvia will be consistent with the strategic outline for the years 2006-2010 agreed upon in CRR 3 with respect to graduation and will be based on the following operational objectives:

- Provide higher-risk products for local corporations to fund their growth and improvements in efficiency, with a focus on cross-border expansion.

- Provide capital and medium to long-term credit lines to selected financial institutions and strengthen their corporate governance and business practices. Selectively commit capital to new regional equity funds targeting SMEs.

- Promote investments to improve energy efficiency, to develop renewable energy, and contribute to energy security.

- Support the involvement of the private sector in the provision of public services in cooperation with structural and cohesion Funds.

- Actively manage the Bank's portfolio to maintain its high quality.

The Bank will continue to ensure that all EBRD operations in Latvia meet sound banking principles, advance transition, are additional, are consistent with 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 31 July 2008, the Bank's net cumulative business volume in Latvia was EUR 327 million. Exactly 50% of the volume has been with Financial Institutions (ANNEX 2).
This reflects the importance of the sector in a country like Latvia where individual projects are small and often cannot be financed by the Bank directly.
EBRD's commitments in Latvia have had a fairly even trend, with EUR 41.2 million of total new commitments during the strategy period 2005 – 2008.
The portfolio was virtually unchanged at EUR 87 at the end of 2007 from EUR 86 million at the beginning of the year.
As of 31 July 2008, the private sector ratio is at 73% and the non-sovereign ratio at 90%. Equity investments represent 44% of the total portfolio. Portfolio risk rating has worsened to (5.7) compared to the rating at the time of the previous strategy's approval (5.2). This is mainly due to a few recently signed regional projects with risk ratings between 6 and 6.5.
A substantial portion of the current portfolio relates to FI, a reflection of EBRD's strong support to SMEs through bank and leasing company credit lines as well as its role as an investor in regional equity funds.

Current Portfolio Stock (EUR million) – including Regional
(as of 31 July 2008)

No. of Projects	Portfolio	Undrawn Commitment	Operating Assets	Impaired Assets	Performing Assets
3 (direct) 17 (regional)	78.3	16.7	61.6	0	61.6

Sector	EBRD finance (EUR million)	Portfolio share
Corporate		
Property, Tourism & Shipping	3.0	3.8%
Telecom, Informatics & Media	5.0	6.4%
Financial Institutions		
Bank Lending	20.0	25.5%
Non-banking Financial Institutions	0.7	0.9%
Equity Funds	21.6	27.6%
Infrastructure		
Transport	7.4	9.5%
Municipal & Environmental Infrastructure	15.5	19.8%
Power&Energy	5.1	6.5%
Total	78.3	100.0%
Of which debt	43.5	55.6%
Of which equity	34.8	44.4%
Of which private	57.1	72.9%
Of which state	21.2	27.1%
Of which direct	41.2	52.6%
Of which regional	37.1	47.4%
Of which non-sovereign	70.3	89.8%
Of which sovereign	8.0	10.2%

1.2. Implementation of the previous country strategy

The Bank's country strategy for Latvia, approved in November 2005, set four main strategic priorities:

- In the infrastructure sector the Bank will support the upgrade of state transport 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.

Overall, the Bank partially achieved the operational objectives set out in the previous Country Strategy. The Bank continued its support to SMEs through the financing of Rietumu Banka and through investments in regional funds two of which are focusing in the Baltics. During the last strategy period the Bank maintained an active policy dialogue with various Latvian authorities promoting the use of PPP where appropriate, mainly in large infrastructure projects that are being developed. In 2007, the Bank signed a regional operation with a Lithuanian energy saving company, active also in Latvia. The Bank has been working on building a pipeline of projects, focusing on energy security, including energy efficiency and renewable energy, on private sector involvement in the provision of public services and on cross-border investments.

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

1.3.1 The Financial Sector

Banking – The Bank has contributed to the privatisation and restructuring of several local banks, including the largest one - Latvijas Unibanka – that was sold to a foreign strategic investor. Despite consolidation and stability achieved in the financial sector, EBRD also experienced problems in a number of its investments. ***A Lesson Learned*** from the Bank’s operations with Pirma Banka is that it is essential to negotiate an effective shareholders’ agreement as condition of EBRD’s investment, if the Bank is to exercise real influence as a minority shareholder (PEX01-156).

NBFI - In 2001 the Bank had acquired some 24 per cent of the share capital in Balta. Although the investment was plagued by management misconduct that led to the dismissal of management, the company continues to be the market leader. The Bank has also been active in the leasing sector under the EU SME framework especially its regional project with Hansa Capital leasing company, under which EUR 18 million was allocated to Latvia.

SME & MSME – Since 2000, the Bank has been successful in reaching SMEs through the EU/SME facility. Although only two banks, Unibanka and Rietumu, were included, they extended loans amounting to almost Euro 60 million with over 90 per cent located outside of the capital. The SME sector also benefited from TC measures for institution building as well as numerous TAM and BAS initiatives.

Private equity funds - Since the late 1990s the Bank has been active through a number of regional private equity funds, such as Baltic Small Equity Fund, and the Baltic Investment Funds with some attractive returns. However, equity funds have found it more difficult to find attractive investment opportunities in the country as compared to Estonia and Lithuania.

Overall, transition impact within the *Financial* Sector is rated *Moderate*.

1.3.2 The Enterprise Sector

Agribusiness - The Bank was indirectly involved in the sector through the Baltic Food Holding, the largest operator of supermarkets and food wholesalers in the Baltic States, and a regional project with the Kesko retailer. The transition impact derived from market expansion and increased competition in food retailing and wholesaling, however is considered to be limited to larger cities.

Property & Tourism – The Bank's participation in a hotel privatisation was the first operation in the sector to be co-financed by an export credit agency, which agreed to take on the project risk. The financing of the first modern office building Riga suffered from unfavourable tax regulations applying to new buildings at the time. A ***Lesson Learned*** from the Valdemara Center is that property development projects involving foreign investors and privatisation of land in primary locations may suffer significant delays during political campaigns and pre-election periods (PE01-190).

Telecommunications - Baltcom GSM, the privately owned Latvian mobile company, has been supported by the Bank since 1997. EBRD has not been involved in investments in fixed line segments, nor policy dialogue for improving legislation. The main ***Lesson Learned*** from Baltcom is that the Bank should thoroughly asses the risk posed by the lack of an independent regulator, especially when the competitor is a state-owned entity (PEX99-180).

Overall, transition impact within the *Enterprise* Sector is rated *Minimal*.

1.3.3 Infrastructure

Power – With the help of EBRD TC funds and substantial EU grant funding finally available, the safety of the hydro-electric dams systems on the Daugava River has been improved. In addition, the Bank assisted the Ministry of Economy in establishing an independent public utilities regulator. A ***Lesson Learned*** by the Daugava Hydro Schemes

Upgrade Project is the necessity to undertake a thorough review of the feasibility study prior to investment commitments (PEX02-170).

Energy Efficiency - The Bank's 1992 energy sector emergency investment project has made an early contribution to energy efficiency and energy conservation through a number of sub-projects with complementary TC operations. A ***Lesson Learned*** with in the Bank's Emergency Investment Project is the importance to avoid complicated upgrading of existing technical systems, especially IT, but to rather install completely new systems (PE97-083).

MEI – In 2000 the Bank has signed the first direct corporate loan to a local service utility in Latvia, the Riga Water Company. The *Municipal Support Agreement* proved to be a successful instrument and progress in regulatory reform and commercial restructuring of the Company is very good. A ***Lesson Learned*** from the Riga Water project is for the Bank to stipulate a tariff formula to which the contracting parties have to subscribe before closure of the loan agreement, in order to secure the project's financial viability (PE02-209).

Transport – Apart rehabilitation measures in the road and airtraffic sub-sectors, the Bank made two investments in the Ventspils Port. The Rail Terminal, and the Multi-Purpose/Inter-Modal Terminal projects successfully demonstrated private sector participation in the financing and operating of port infrastructure. A ***Lesson Learned*** from the Ventspils Port operations is to carry out a thorough traffic analysis as an essential quality-at-entry input element for any transport project (PEX02-168).

Overall, transition impact within the *Infrastructure* Sector is rated *Moderate.*

1.4 Selected lessons learned

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 **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.

2. OPERATIONAL ENVIRONMENT

2.1 General Reform 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 led to 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 the oil transit company Ventspils Nafta. In addition, there has been progress in improving the business environment and enhancing supervision in the financial sector. The government has also made significant progress in restructuring the railways and liberalising the energy markets. The National Development Plan agreed in 2007 provides mid-term strategic planning for regional development planning in Latvia for the period 2007-2013, with the main focus on education and knowledge.

2.2 Political developments

The latest parliamentary elections, held on 7 October 2006, saw the re-election of the government for a second mandate. Following brief negotiations, the former ruling coalition – including the People’s Party of Prime Minister Aigars Kalvītis, the Union of Greens and Farmers and First Party-Latvia’s Way (LPP/LC) – was preserved albeit reformed. The fourth partner, the conservative nationalist TB-LNNK, was also invited into the coalition. Kalvītis retained the premiership and many Ministers also retained their posts.

In 2007 a string of ministerial walk-outs and street protests in the capital Riga over alleged abuse of power by Prime Minister Kalvītis precipitated his resignation (along with his government) in early November 2007. Latvia’s President Valdis Zatlers, who himself had been recently elected, entrusted the formation of the new government to Ivars Godmanis from LPP/LC, independent Latvia's first PM, who last served as head of government from 1990-1993. The new government, comprising the same four coalition partners, was confirmed with 54 votes in favour and 43 against in Latvia's 100-seat Parliament.

The Godmanis government has so far not presented any major shifts in policy intentions, although its room for manoeuvre is limited by the continuing mood of popular discontent.

2.3 Environmental issues

Latvia's objectives of environment and sustainable development are defined in the Strategy for Sustainable Development of Latvia (2002) and the National Environmental Policy Plan (2004). The National Environmental Policy Plan ("NEPP") takes into account the European Union standard acts and policy documents, including the 6th European Community Environment Action Programme "Environment 2010: Our Future, Our Choice", as well as binding documents of the UN and other international institutions.

The NEPP together with other planning documents in the economic and social spheres is to become a unified basis for the establishment and implementation of the national sustainable development policy.

The main objective of the NEPP is to assure environmental conditions that are beneficial to human health, will increase the public welfare and human lifespan, bringing living standards and the level of economic development close to the average level in the European Union countries.

The following key conclusions have been made in the NEPP after analysing the environmental situation in Latvia and taking into account strategic guidelines of the country's main industries:

1. Low-residue production based on modern technologies is to be implemented for efficient use of natural resources assuring high energy efficiency and establishing a hazardous waste management infrastructure. Implementation of the principle "the polluter pays" will result in reduction of the quantity of pollutants emitted into air, water and soil.
2. The main wealth of Latvia and the base of its welfare is land, which is not used in a sustainable way. Developing biological and environmentally friendly agriculture, as well as generation of income that is alternative to agriculture, it is vital to retain biological diversity and to prevent the degradation of rural landscape, thus assuring sustainable use of agro-environmental resources.
3. Intensive transport traffic and air pollution in large cities have become problems on a national scale. Within the next few years the task of the Ministry of Environment, Ministry of Regional Development and Local Government, and Ministry of Transport will be to improve air quality, using economic and organisation methods, as well as emphasising the growing importance of transport planning.
4. Although Latvia has sufficient water resources to satisfy its population and business needs, not all people have access to clean drinking water. Therefore special attention needs to be paid to improvement of water quality and successful implementation of initiated programmes.
5. Latvia has a great diversity of ecosystems and their natural structures, as well as local wild species, agricultural plants and animal species. Such diversity is to be

retained not only for assurance of the healthy living environment and sustainable development in Latvia, but also in fulfilment of international liabilities.

6. Including requirements of standard acts in planning documents of all levels is of great importance for implementation of the National Environmental Policy Plan.
7. Informing and wider involvement of society in settlement of environmental issues is of decisive importance in forming a civil society.

The National Environmental Policy Plan defines environmental protection principles, main goals of the Policy and measures for their achievement. Special attention is paid to integration of the Environmental Policy in all industries of Latvian national economy, as well as at the level of national, regional and local planning.

The implementation of the goals of the environmental policy and sustainable development strategy are realised with help of legislation system and institutional framework. Latvia essentially had implemented the EU *acquis* in all areas of environment policy by its EU accession in May 2004. Four years of Latvia's EU membership has furthered the progress in implementation of the few transitional arrangements that were agreed in Latvia's EU Accession Treaty.

The compliance with the *acquis* has required and will continue to require significant investment, but it also brings significant public health and socio-economic benefits.

2.4 Legal reform

The overarching goal of the Latvian legislature remains to ensure effective harmonisation of the Latvian laws with corresponding legislation and policies (*acquis communautaire*) of the European Union. Newly introduced and amended legislation both in public and private sectors of regulation is aimed at supporting free market economy, promotion of private enterprise and integration into the international economic system. Recent notable developments include:

- 2007 amendments to the Financial Instruments Market Law that implement relevant EU directives and streamline, *inter alia*, improved transparency of public companies, regulation of mandatory takeover bids and protection of minority shareholders;
- new Public Procurement Law that implements the EU directive 2004/18/EC, which is expected to make public procurement more flexible and simple;
- enacting on 1 March 2006 of the Rome Convention that establishes uniform rules concerning the law applicable to contractual obligations;
- amendments to the Civil Procedure Law (in 2006) that improved enforcement of foreign judgments, revised allocation of jurisdiction between regional and district courts;
- new law on Prohibition of Unfair Commercial Practices (effective from 1 January 2008) that sets forth grounds for recognising practices unfair, misleading or aggressive and vests certain powers to the supervising authorities with respect to protection of consumer rights; and

- pursuant to amendments to the Investor Protection Law (adopted on 24 May 2007) amount of reimbursable losses of an investor, resulting from improper services of investment service provider licensed by the Financial and Capital Market Commission, were increased.

Latvia has a developed legal system matching that of advanced transition countries and, in many areas, approaching international standards. The laws are supported by properly established institutional mechanisms to implement them. Continued alignment of Latvian laws with EU laws also helped to improve the quality of the legal environment in the country. However, as described in Annex 8, there are challenges that ought to be addressed, in particular in the areas of effectiveness of corporate governance legislation and concessions. In addition, enhancing the quality of the judiciary, and tackling corruption remain important priorities for Latvia.

2.5 Macroeconomic conditions relevant for the Bank's operations

Economic activity remained strong in 2007, with real GDP growing by 10.3 per cent. There was however a marked slowdown towards the end of the year and in early 2008. 2007 was the third consecutive year of double-digits real GDP growth. As in previous years, real GDP was mainly supported by robust growth in both private consumption and investment. Rapid growth has been accompanied by rising inflation which reached a ten-year high of 16.7 per cent in July 2008, the highest in the EU. The central bank increased its refinancing rate twice in 2007 in order to stem inflation and curb the overheating economy. In addition, the government has introduced a number of anti-inflation measures and a rising risk aversion among banks has also led to more cautious lending practices. These factors had a noticeable effect in reducing credit growth and house price increases, leading also to moderating domestic demand more recently. In early 2008, the central bank reduced the minimum reserve ratio for bank liabilities with agreed maturity over two years in two steps to 6 per cent with a view of supporting the financial sector to attract long-term funding.

The labour market remains tight with unemployment falling towards 5.5 per cent in early 2008 and the number of employed have now reached the highest level since the start of transition. As a consequence, wage growth has accelerated, to an annual average of 31.5 per cent in 2007. Although a part of this high wage growth reflects the legalisation of wages (with the State Revenue Service launching a campaign against wage underreporting and taxable income determining the possibility to get a bank loan), real wages rose faster than productivity, leading to upward pressure on inflation. The situation in the labour market is gradually easing, though wage pressures remain. The tight labour market is partly due to emigration, mainly to other EU countries, albeit in 2007 it slowed down notably. Measures to secure labour supply in the medium term are consequently of key importance.

The current account deficit started to narrow in the course of 2007 but remained high at 22.8 per cent of GDP for the year as a whole. This mainly reflected developments in the trade balance, with imports starting to decelerate. Latvia retains a dual structured export pattern with comparatively higher-value-added goods exported predominantly to the CIS, whereas exports to the EU consist mainly of lower-value-added production. This results in low levels of innovation and sluggish productivity growth.

In 2007, the government actively addressed the growing macroeconomic imbalances. Apart from avoiding spending wind-fall tax revenues stemming from high growth, the government's anti-inflation plans include a taxation of income from the sale of real estate (targeted at property owned for less than five years) from 2010, several measures to dampen credit expansion and a proposal to restrict public sector wage growth. The consolidated general government recorded a balanced budget in 2007. The government postponed earlier plans to cut the rate of personal income tax from 25 to 15 per cent, while the growth in revenues remains strong. In January 2008, the government proposed additional measures, relating to fiscal consolidation, tax policy and efficiency of public administration, in order to stabilise the economy.

Overall growth is expected to decelerate sharply, as domestic demand moderates on the back of decelerating credit growth, declining house prices and reduced consumer confidence. While leading to a sizeable correction, the magnitude of the domestic and external imbalances suggests that the adjustment could be relatively protracted. A minor speculative attack on the currency in early 2007, combined with the high proportion of euro denominated loans, show that Latvia could be vulnerable to financial turmoil and changes in the exchange rate. However, the authorities have no intentions to change the current exchange rate regime and its reserves remain high. Moreover, the banking sector is overall sound.

2.6 Transition Successes and Challenges

The following sector-by-sector analysis of remaining transition challenges highlights several priority areas (please refer to Annex 5 for a table of the 2005 Assessment of Transition Challenges (ATC)).

Enterprise sector

General industry: *given the pressures on the labour market, policy measures are needed to improve skill levels in the labour force and increase long-term competitiveness*

Although the business environment remains one of the best in the region and labour costs in absolute levels are low, the decline in unemployment and above-productivity wage increases in major industries has put additional pressure on overall competitiveness. This, combined with rising energy costs, emphasises the need for restructuring and investment, in particular in energy-intensive industries. Policy measures are needed to improve skill levels in the labour force.

SMEs: *red tape being cut for Latvian SMEs and equity capital remains scarce.*

Small and medium sized enterprises (SME) form the backbone of the Latvian economy and are crucial providers of employment and services, particularly in the poorer areas of the country. SMEs continue to suffer from a lack of institutional capacity although improvements are underway. Starting a business is less costly than elsewhere in the region. According to the latest 2008 World Bank Doing Business survey it only takes 5 different procedures, an average of 16 days at a cost equal to 3 per cent of gross national income per capita, which is close or better than the OECD average. In January 2008 the Bank of Latvia launched the national Credit Registrar for borrowers and guarantors of loans in Latvia. which replaces the previously existing Credit Register. Collateral and bankruptcy legislation are supportive of SME lending and the cost of registering collateral is low. Commercial banks and leasing companies have been very active in extending loans or leases to SMEs, often under dedicated IFI-supported credit lines. However, equity for SMEs remains scarce.

Agribusiness: *as elsewhere in the region, agribusiness enterprises would benefit from improvements in efficiency and an upgrade in hygiene standards.*

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. A more efficient food production would also alleviate supply pressures which have increased in the recent year. 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, including primary food production.

Financial sector

Banking sector: *The financial sector is generally sound, although fast credit growth over recent years is exposing the sector to heightened risks.*

The restructuring of the sector has been completed, and the industry is almost entirely in private hands (only 5.5 per cent of the banks' total paid-up share capital was owned by the state at the end of 2007, concentrated in one bank, Latvijas Hipoteku un zemes banka). Foreign-owned banks, half of the 24 banks in the country, hold 73 per cent of the total bank capital. A combination of low nominal, and negative real interest rates and a highly competitive banking sector contributed to a high annual growth of domestic credit in recent years, which in relation to GDP rose to 94 per cent by the end of 2007. The basic regulatory framework in the banking sector is in place. Regulation and financial supervision have been tightened as tax fraud and money laundering remain a concern. In view of combating domestic and external imbalances, the government took a number of measures, which partly took effect in mid-2007, to moderate credit growth (which increasingly has been denominated in foreign currency). These included a 10per cent downpayment required for bank loans to private persons, income confirmations from tax authorities needed to receive bank loan, tax on capital gains from real estate sale if owned by less than 5 years and the creation of a central credit register. In April 2008 the Cabinet of Ministers of the Republic of Latvia approved the proposed amendment to the "Consumer Rights Protection Law" regarding cancellation of initial down payment requirements of 10 per cent, subject to parliamentary approval.

Equity markets: *Despite progress, availability of external equity capital is still scarce.*

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.

Infrastructure sectors

Energy: *energy security and energy efficiency are increasing priorities, there is also room for increased competition*

The liberalisation of the power sector has been largely completed and efforts are now focussed on ensuring energy security and increasing efficiency. Latvenergo has been unbundled, although its privatisation is not envisaged. Market liberalisation is being introduced according to EU requirements. As a result, industrial consumers and rival suppliers gain free access to the state-owned Latvenergo's transmission grids. As of July 2007, Latvian consumers are able to choose an electricity supplier within the EU. The national target of Latvia is to increase the share of electricity produced from renewable energy sources from 45% to 49% in final electricity consumption by 2010. Tariffs are cost reflective and there is an independent regulator. Energy supply issues remain a challenge, in particular with a view of the closure of Ignalina Nuclear Power Plant due in 2009 which is likely to lead to significantly higher electricity prices.

The basic institutions for the energy efficiency sector are in place. The country has ratified the Kyoto protocol and has 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. However, government agencies have been slow in considering and approving renewable projects and conditions of many approvals fell short of investors' expectations. Furthermore, more can be done to stimulate energy efficiency improvements among households and small enterprises, which often lack awareness of the issues and financing options.

Municipal services: *there is significant scope for private involvement in the delivery of public services and in EU financed projects.*

As elsewhere in the Baltic region, the municipal sector in Latvia remains fragmented and suffers from low administrative capacity. Very few of the 551 municipalities can access external financing on reasonable terms. 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. With substantial fiscal pressures on municipal finances there is an increasing scope for private involvement in increasing efficiency in the delivery of public services.

Transport: *restructuring of the railways sector is underway.*

The reorganisation of the Latvian railways has been completed and fulfils the requirements of the relevant EU directives. With increasing urban traffic, especially in the capital, major investments in roads and public transport are envisaged. Due to the size of these investments private sector participation seems necessary.

3. STRATEGIC ORIENTATIONS

3.1 Bank's Priorities for the Strategy Period

In response to the analysis of Latvia's remaining transition challenges, the Bank's main focus during the strategy period will be to

- Provide higher-risk products for local corporations to fund their growth and improvements in efficiency, with a focus on cross-border expansion.
- Provide capital and medium to long-term credit lines to selected financial institutions and strengthen their corporate governance and business practices. Selectively commit capital to new regional equity funds targeting SMEs.
- Promote investments to improve energy efficiency, to develop renewable energy, and contribute to energy security.
- Support the involvement of the private sector in the provision of public services in cooperation with structural and cohesion Funds.
- Actively manage the Bank's portfolio to maintain its high quality.

This Strategy will be implemented in accordance with the strategic outline for the years 2006-2010 agreed upon in CRR3 with respect to graduation.

3.2 Sectoral Challenges and Bank Objectives

3.2.1 Enterprise Sector

Transition Challenges

Corporate governance and market competitiveness are relatively weak. The government's ambitious strategy to identify and develop Latvia's human capital resources in education, science and technology, as outlined in the Latvian National Development Plan 2007-2013, will need to be supported by further concrete measures. In view of competitiveness challenges, combined with rising energy costs, restructuring and investment in energy-intensive industries will be a priority.

Operational Priorities

- Provide equity investments to companies that require restructuring or corporate governance support, environmental investments and/or or cross-border investments.

- Support companies' investments in energy efficiency and improvements in competitiveness.

3.2.2 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. Although credit growth has been strong in recent years, there is a lack of equity and mezzanine capital to support growth of SMEs. SMEs in rural areas, including agribusiness, will stand to gain from increased access to capital in order to raise efficiency.

Operational Priorities

- Where appropriate, strengthen banks' corporate governance and business practices.

- Provide long-term capital to selected mid-tier banks that lack a strategic owner.

- Selectively commit capital to new regional equity funds, particularly those which focus on SMEs and/or agribusiness.

3.2.3 Infrastructure and Environmental Sector

Transition Goals

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 significant unnecessary operating costs due to heat losses from municipal-owned heating networks and buildings and privatised industrial enterprises. Latvia remains highly reliant on energy imported from neighbouring countries, particularly Russia and Lithuania.

Operational Priorities

- Encourage and support private sector participation in the financing of municipal and transport infrastructure. Where possible these projects will be complemented with EU funding.
- Improve energy efficiency.
- Support the development of alternative energy sources and contribute to energy security.

3.3 Portfolio management challenges

The Bank will structure its portfolio management in such a way that it is able to maintain the current high quality of the portfolio and project monitoring by the Vilnius Resident Office staff. The Bank will work to ensure that the eventual graduation of Latvia from EBRD operations does not represent a disruption in portfolio management, including monitoring.

4. CO-OPERATION WITH OTHER IFIs AND THE EU

4.1 European Union (EU)

The EU has committed a total of €4.6 billion in cohesion and structural funds for the period 2007-2013. For the period 2004-2006, absorption of EU funds, affected by e.g the administrative capacity to control projects, ensure efficient implementation and provide co-financing, picked up only slowly but should now be sufficiently advanced to draw full benefits of the committed EU funds within the set timeframe. As laid down in the Latvian National Strategic Reference Framework (NSRF), the EU funding will be invested in three strategic objectives:

- development and efficient utilization of human resources;
- strengthening competitiveness and progress towards a knowledge-based economy;
- improvements in public services and infrastructure as a precondition for balanced national and territorial development.

Among other things, the funds will concretely contribute to urban development in Latvia. Currently most social and economic activities are concentrated in the capital city Riga and around it, which hosts almost half of the Latvian population. To foster more diversified and balanced development of the country, the ERDF will support the development of 17 cities, including Riga (amounting to € 263 million).

The focus will also be on the improvement of the efficiency of public administration, a prerequisite for the management of EU funds. The EU contribution will help to compensate for gaps in the education system and will contribute to the creation of new firms and to the improvement of the national road and rail network.

4.2 The European Investment Bank (EIB)

Since 2002, the EIB has committed a total of €364 million for projects in Latvia, mainly through a EUR150 million co-financing programme with EU Structural and Cohesion Funds and through global loans to banking intermediaries for financing of small and medium-sized enterprises (SMEs). 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.

4.3 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.

4.4 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, with additional lending of up to US$120 million planned over the next three years. 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. No new loans have been made since December 2000 and in early 2007 Latvia graduated from World Bank borrower status.

4.5 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$53.5 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. The Bank has not collaborated on any concrete projects with the IFC in Latvia.

4.6 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. During 2007 NIB has financed three operations in Latvia. Valsts Nekustama Ipasuma Agentura (VNIA), Latvia's state real estate company, received a loan totalling EUR 10.3 million to be used for the renovation of a building to be rented out to the country's Ministry of Foreign Affairs. A loan to Latvenergo A/S of EUR 50 million will be used for financing Latvenergo's investment programme, which includes the rehabilitation of the transmission and distribution network and the modernisation of the heat and power plant TEC-2 in Riga, as well as other energy efficiency projects. The 30-year-maturity loan totalling EUR 27 million will finance the development and modernisation of the Riga Psychiatric Clinic's (RPC) infrastructure. The Bank has collaborated on a number of environmental projects with NIB in Latvia.

4.7 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. In 2007 KfW concluded a EUR30 million global loan agreement with Hipoteku Banka to support the SME sector. The Bank has not collaborated on any concrete projects with KfW in Latvia.

ANNEX 1: NET CUMULATIVE BUSINESS BY INDUSTRY

(as of 31 July 2008)

Sector Team (SIC)	Total Project Value	EBRD Finance	% Share of Commitments
Corporate			
Agribusiness	65	16	5%
General Industry	0	0	0%
Property and Tourism	52	15	5%
Telecoms Informatics & Media	309	20	6%
Sub-total Corporate	**429**	**51**	**16%**
Energy			
Power and Energy	99	44	13%
Sub-total Energy	**99**	**44**	**13%**
Financial Institutions			
Bank Equity	94	20	6%
Bank Lending	137	74	22%
Equity Funds	83	39	12%
Non Bank Financial Institutions	58	29	9%
Sub-total Financial Institutions	**373**	**162**	**50%**
Infrastructure			
Municipal & Env Inf	185	30	9%
Transport	142	40	12%
Sub-total Infrastructure	**327**	**70**	**21%**
LATVIA TOTAL	**1,224**	**327**	**100%**

ANNEX 2: SELECTED ECONOMIC INDICATORS

	2002	2003	2004	2005	2006	2007 *Estimate*	2008 *Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP	6.5	7.2	8.7	10.6	12.2	10.3	1.2
Private consumption	7.4	8.2	9.8	11.2	21.2	13.9	na
Public consumption	2.2	1.9	2.1	2.7	4.9	4.8	na
Gross fixed capital formation	13.0	12.3	23.8	23.6	16.3	8.4	na
Exports of goods and services	5.4	5.2	9.4	20.3	6.5	11.1	na
Imports of goods and services	4.7	13.1	16.6	14.8	19.3	15.0	na
Industrial gross output	8.8	8.0	8.3	8.4	10.5	5.4	na
Agricultural gross output	4.4	-2.4	3.3	9.4	-5.2	8.2	na
Employment			*(Percentage change)*				
Labour force (end-year)	1.7	0.2	0.9	-0.1	2.9	2.0	na
Employment (end-year)	3.0	1.8	1.1	1.8	5.0	2.9	na
			(In per cent of labour force)				
Unemployment (end-year)	12.0	10.6	10.4	8.7	6.8	6.1	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	1.9	2.9	6.2	6.7	6.5	10.1	16.0
Consumer prices (end-year)	1.5	3.6	7.3	6.9	6.9	14.2	11.5
Producer prices (annual average)	1.0	3.2	8.6	7.8	10.3	16.1	na
Producer prices (end-year)	0.8	4.1	11.4	7.0	13.2	13.1	na
Gross average monthly earnings in economy (annual average)	8.8	11.0	9.9	16.6	22.8	31.8	na
Government sector			*(In per cent of GDP)*				
General government balance	-2.3	-1.6	-1.0	-0.4	-0.2	0.0	-0.4
General government expenditure [1]	35.6	34.8	35.8	35.6	37.9	38.0	na
General government debt	13.5	14.6	14.9	12.4	10.7	9.7	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	21.0	19.1	26.9	38.7	39.7	14.4	na
Domestic credit (end-year)	39.8	47.3	40.4	57.6	53.4	32.7	na
			(In per cent of GDP)				
Broad money (M2, end-year)	32.4	34.7	37.9	43.1	48.8	44.7	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinancing rate	3.0	3.0	4.0	4.0	5.0	6.0	na
Interbank market rate [2]	3.1	3.5	3.5	2.3	4.2	8.5	na
Deposit rate (short-term, under 1 year)	3.2	3.0	3.3	2.8	3.6	6.2	na
Lending rate (short-term, under 1 year)	7.5	5.4	7.5	5.9	7.2	10.0	na
			(Lats per US dollar)				
Exchange rate (end-year)	0.6	0.5	0.5	0.6	0.5	0.5	na
Exchange rate (annual average)	0.6	0.6	0.5	0.6	0.6	0.5	na
External sector							
			(In millions of US dollars)				
Current account	-624.8	-922.1	-1,775.5	-1,999.8	-4,522.0	-6,231.3	-6,444.5
Trade balance	-1,479.0	-2,004.6	-2,782.2	-3,016.5	-5,130.7	-6,679.2	-7,034.5
Merchandise exports	2,545.0	3,169.6	4,220.3	5,355.6	6,140.3	8,143.0	9,714.6
Merchandise imports	4,024.0	5,174.2	7,002.5	8,372.1	11,271.0	14,822.2	16,749.1
Foreign direct investment, net	250.3	254.0	528.5	584.1	1,492.1	2,136.3	2,000.0
Gross reserves, excluding gold (end-year)	1,241.4	1,432.4	1,912.0	2,231.9	4,353.3	5,553.1	na
External debt stock [3]	7,043.1	9,400.0	13,448.5	15,179.2	23,769.0	38,689.7	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	3.2	2.8	2.8	2.7	3.9	3.8	na
			(In per cent of exports of goods and services)				
Debt service	15.9	19.9	21.4	36.4	39.8	27.4	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	2.3	2.3	2.3	2.3	2.3	2.3	na
GDP (in millions of lats)	5,758.3	6,392.8	7,434.5	9,059.1	11,171.7	13,957.4	16,384.9
GDP per capita (in US dollars)	3,971.1	4,799.0	5,935.1	6,953.0	8,688.1	11,913.2	na
Share of industry in GDP (in per cent)	20.5	20.0	19.9	19.1	19.3	19.4	na
Share of agriculture in GDP (in per cent)	4.1	3.7	4.0	3.5	3.1	2.9	na
Current account/GDP (in per cent)	-6.7	-8.2	-12.9	-12.5	-22.7	-22.9	-17.9
External debt - reserves (in US$ million)	5,801.7	7,967.6	11,536.6	12,947.3	19,415.8	33,136.6	na
External debt/GDP (in per cent)	75.6	84.0	97.7	94.7	119.2	142.4	na
External debt/exports of goods and services (in per cent)	186.2	201.1	224.1	201.8	270.6	326.8	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 3: RATINGS FROM THE 2005 ASSESSMENT 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. New regulation and better enforcement in place reducing against money laundering..
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 could be further improved. Curbing primarily political corruption, reducing tax evasion and VAT fraud remain 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 less costly than elsewhere in the region. A credit registry is being set up and a private credit information bureau exists. Collateral and bankruptcy legislation supportive of MSME lending. Cost of registering collateral is low. Credit to SMEs has expanded rapidly.
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*	Securities and insurance markets legislation and regulation almost meet IOSCO / 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 has been unbundled, but privatisation is not envisaged. The market is being liberalised according to EU targets. Tariffs are cost oriented and there is an independent regulator. Latvia remains highly 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. New plans for the sale are currently under discussion. 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*	The reorganisation of the Latvian railways has been completed. The state-owned company LDz is now a holding company and will be the railway infrastructure manager. As a result of the reorganization, Latvia has fulfilled the requirements of the EU directives on liberalising the railway sector. In roads, construction and design companies have been privatised. Road user charges have increased, but still do not cover operating costs. National road networks are in relatively poor condition.

ANNEX 4: COMPARATIVE STRUCTURAL CHANGE INDICATORS

	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Slovakia	Slovenia
Liberalisation								
Share of administered prices in CPI (in per cent)	20.7	23.3	15.1	14*	13.5	1*	23.4*	17.4*
Number of goods with administered prices in EBRD-15 basket	2.0	2.0	1.0	2*	1.0	1*	2*	1*
Share of trade with non-transition countries (in per cent)	75.8*	78.3*	75.2*	53.6*	52.1*	78*	61.5*	74.5*
Share of trade in GDP (in per cent)	126.9	133.1	129.6	84.8	100.0	90.4	163.1	121.9
Tariff revenues (in per cent of imports)	na	0.3*	na	na	na	na	0*	0.2*
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)	25.3*	na	35.3*	na	na	14*	35.2*	5*
Private sector share in GDP (in per cent)	80.0	80.0	80.0	70.0	75.0	75.0	80.0	70.0
Private sector share in employment (in per cent)	na	74.3*	na	76.0	na	73.2*	na	71.0
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)	na	1.4*	na	na	0.8*	0.8*	1.4*	3.7*
Share of industry in total employment (in per cent)	40*	25.9*	31.9*	18*	19.7*	31.1*	29*	29.5*
Change in labour productivity in industry (in per cent)	8.3*	15*	10.2*	-1.2*	10.4*	1.5*	7.2*	9.4*
Investment/GDP (in per cent)	25.6	38.2*	21.9*	38*	28*	20.6*	26.0	27.7
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	3.7	3.3	3.0	3.3	3.3	3.3	2.7
Infrastructure								
Fixed-line (mobile) penetration rate (per 100 inhabitants) *	31.5 (119.0)	40.9 (125.2)	33.3 (99.0)	28.6 (95.1)	23.2 (138.1)	29.8 (95.5)	21.6 (90.6)	42.6 (92.6)
Internet users (per 100 inhabitants)*	34.7	57.4	34.8	46.7	31.7	28.6	41.8	63.6
Railway labour productivity (1989=100) *	97.3	333.7	177.5	106.7	83.0	102.4	71.1	175.8
Residential electricity tariffs (USc kWh)	15.3	10.7	na	8.9	12.0	10.8*	14.0	14.0
GDP per unit of energy use (PPP in US dollars per kgoe)	na	na	na	na	na	na	na	na
EBRD index of infrastructure reform	3.3	3.3	3.7	3.0	3.0	3.3	3.0	3.0
Electric power	3.3	3.3	4.0	3.3	3.3	3.3	4.0	3.0
Railways	3.0	4.0	3.7	3.7	2.3	4.0	3.0	3.0
Roads	3.0	2.3	3.7	2.3	2.3	3.0	2.3	3.0
Telecommunications	4.3	4.0	4.0	3.0	3.7	4.0	3.7	3.0
Water and waste water	4.0	4.0	4.0	3.3	3.3	3.3	3.3	3.3
Financial sector								
Number of banks (foreign-owned)*	37 (28)	14 (12)	40 (28)	24 (12)	11 (6)	64 (53)	24 (16)	25 (10)
Asset share of state-owned banks (in per cent)*	2.2	0.0	7.4	4.4	0.0	21.1	1.1	12.6
Non-performing loans (in per cent of total loans)*	3.8	0.2	3.0	0.5	1.0	8.3	na	5.6
Domestic credit to private sector (in per cent of GDP)*	39.9	78.4	54.6	77.9	47.7	33.4	39.2	67.1
Stock market capitalisation (in per cent of GDP)*	31.5	34.6	34.1	12.8	32.6	41.0	8.9	49.9
EBRD index of banking sector reform	4.0	4.0	4.0	4.0	3.7	3.7	3.7	3.3
EBRD index of reform of non-bank financial institutions	3.7	3.7	4.0	3.0	3.3	3.7	3.0	2.7

* Data for 2006

ANNEX 5: POLITICAL AND SOCIAL ASSESSMENT

Political context

On regaining independence in 1991, Latvia established a multiparty, parliamentary democracy. The prime minister serves as head of government. Formal executive power is vested in the president, who is elected by parliament (*Saeima*) for a four-year term (amended from a three-year term in December 1997). Although the presidency is largely ceremonial, the president is nevertheless responsible for appointing the prime minister, who then appoints the council of ministers. The nominated council of ministers are then subject to approval by the Saeima. The Saeima is a unicameral parliament with 100 members elected for four-year mandates on a purely proportional representation basis with a threshold of five per cent for parties to enter parliament. Latvia has held five parliamentary elections and four major national referenda since independence. The next parliamentary elections are due to take place by October 2010, although the fragile balance of power in the current ruling coalition might lead to early elections.

The most recent parliamentary elections, in October 2006, resulted in ten parties (grouped into seven electoral coalitions) crossing the five per cent threshold to enter the Saeima. The largest of these, the People's Party led by then-Prime Minister Aigars Kalvītis, took just less than 20 per cent of the popular vote and received 23 of the Saeima's 100 seats. This enabled Kalvītis to reconstitute the former ruling coalition – the first time since independence that a government coalition had been re-elected in Latvia – which also included the Union of Greens and Farmers, who had 18 seats at the time, and First Party-Latvia's Way (LPP/LC), with 10 seats. Not only did Kalvītis retain the premiership, but many ministers also retained their posts although the division of ministerial portfolios was reshuffled slightly. Kalvītis also invited the small conservative nationalist party, For Fatherland and Freedom/LNNK (TB-LNNK), who had won eight Saeima seats, into the coalition, to give the governing coalition a firm majority of 59 seats.

Since the parliamentary elections Latvia's political party system has remained highly fragmented, with frequent party defections and the formation of often short-lived opposition coalitions. However, unlike previous Latvian coalition governments the Kalvītis-led coalition was able to hold together despite differences in political outlook and preferences: Kalvītis' People's Party generally tends to favour more liberal economic policies, while both the Union of Greens and Farmers and LPP/LC favour more state intervention and subsidies to rural dwellers in particular. This was particularly remarkable as party politics in Latvia remains highly individualised, rather than driven by programmatic or ideological goals, which has paved the way for the penetration of business and economic interests into the Latvian political system. As a result, the Kalvītis government proved unable or unwilling to address seriously Latvia's significant high-level political corruption. Despite the coalition's unexpected longevity, a series of high-level political corruption scandals during the course of 2007, culminating in a highly unpopular decision by Kalvītis in October 2007 to suspend Aleksejs Loskutovs, the head of Latvia's Corruption Prevention and Combating Bureau (KNAB), prompted street protests and eventually resulted in Loskutovs' reinstatement and Kalvītis' resignation in December 2007.

A new four-party coalition government was formed on 20 December 2007, headed by Latvia's first post-independence Prime Minister, Ivars Godmanis from LPP/LC. The new coalition includes the same four parties as the Kalvītis government and many of the same ministers, and has a narrow majority of just 53 seats in the Saeima. The Godmanis government has not revised the governing programme significantly or taken a more proactive stance toward addressing the country's remaining structural reform agenda. This reticence to address the country's remaining structural reforms is due to two separate constraints on the government: the need to preserve the delicate coalition balance, and the continuing mood of popular discontent in Latvia, fuelled by high levels of inflation and the threat of major falls in property prices. Political corruption also remains a concern: after further revelations of embezzlement within KNAB, Loskutovs was finally removed from office in June 2008, but the Government has yet to decide on new procedures to choose his replacement which can be accepted by all political parties as independent and depoliticised. While there are several ongoing corruption investigations of high ranking officials and politicians by both the Prosecutor's General Office and KNAB, tackling high-level political corruption in a systematic way – which might help alleviate some social discontent – might also threaten to unravel the coalition government, and as a result is not a high priority for the Godmanis government.

International relations

The core foreign policy priorities of post-independence Latvia – shared by virtually the entire spectrum of political parties and elites – have been Latvia's 'return to Europe' project and the consolidation of Latvian independence. Having achieved both NATO and European Union membership in 2004, both of these ambitions have been largely realised. Popular support for Latvia's European orientation remains strong, and, following the signing of the European Union Lisbon Treaty in December 2007 by Latvian President Valdis Zatlers, it was adopted by the Saeima in early-May 2008 and came into force on 29 May 2008. Like many other new EU member countries in Central Eastern Europe and the Baltic region, Latvia remains strongly committed to an Atlanticist perspective in its strategic foreign relations.

Unlike its Baltic neighbours Lithuania and Estonia, Latvia continues to enjoy relatively friendly relations with the Russian Federation. This is in part because Russian businesses have secured greater access to the Latvian market than to either of Latvia's two Baltic neighbours, and as a result a substantially higher proportion of the banking sector in particular is linked to Russian interests. Moreover, a border treaty initialled in 1997 was finally signed and ratified in 2007 and entered into force in December 2007. Despite reciprocal tit-for-tat diplomatic expulsions between Riga and Moscow in early-2008 over spying allegations, and despite the continued blockage by Russia of the crude oil pipeline to the Latvian oil terminal at Ventspils, the Latvian political elite has historically been less concerned about politically-associated risks arising from Latvia's energy dependence on Russia. However, Moscow's continuing concerns about the treatment of ethnic Russians in Latvia and historical questions about the Soviet Union's "occupation" of Latvia, on which the two parties hold different positions, are likely to lead to occasional flare-ups in Latvian-Russian relations over the strategy period, but are not expected to lead to any major conflict between the two countries.

Integrity issues

Both high-level political corruption and low-level administrative corruption continue to be a matter of concern in Latvia, which the succession of weak and often short-lived coalition governments has proven unable or unwilling to tackle successfully. According to the international anti-corruption NGO Transparency International, corruption in Latvia declined slightly from 2004 to 2007, with Latvia's score on the Corruption Perceptions Index (CPI) improving from 4.0 to 4.8 (on a 10-point scale where 10 represents no corruption). However, in that time period Latvia has improved only marginally in comparison to its peers in the transition region, moving from 7th to the joint-6th ranked of the 28 transition countries, behind all of the CEB countries except Poland. The US State Department's Bureau of Democracy, Human Rights and Labour annual country report for Latvia issued in March 2007 reiterated concerns about the level of corruption in Latvia, stating that there is a "widespread perception of corruption throughout all levels of the government." The report welcomed the fact that the Corruption Prevention and Combating Bureau had increased its prosecutions from 34 in 2005 to 51 in 2006. However, the large number of high-level political corruption scandals that have since come to light, including one involving Ventspils Mayor Aivars Lembergs who was arrested in March 2007, continue to raise concerns about the pervasiveness of corrupt practices at all levels of the Latvian political system and state administration.

On the positive side, the extent of money laundering – which until recently was a major source of concern in Latvia – has improved significantly in the past three years, as the authorities have initiated several measures to 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 anti-money laundering legislation which brought Latvian laws into line with EU requirements has been actively implemented.

Human trafficking remains a moderately significant problem in Latvia. The US State Department's June 2007 "Trafficking in Persons Report," which covers the period from April 2006-March 2007, ranks Latvia as a "Tier-2" country, which means that Latvia is not fully compliant with US anti-trafficking standards as set out in the 2000 Trafficking Victims Protection Act (TVPA), but that the government is making "significant efforts" to meet the TVPA's minimal standards in combating trafficking. The US State Department report concludes that Latvia is both a source and a transit country for women trafficked for sexual exploitation, with primary destinations including Spain, the UK, Germany, Denmark, Switzerland, Portugal and Norway, as well as both Latvian men and women being trafficked to the UK and Ireland for the purposes of forced labour. The report highlights the active measures that the Latvian government has taken to combat human trafficking, including the 2006 Social Services and Social Assistance Law requiring the authorities to provide social and rehabilitation services to victims of human trafficking, but urges the government to intensify its efforts to identify and assist victims of trafficking by allocating at least nominal funding for repatriation, and by ensuring that all convicted traffickers serve some time in prison.

Social conditions

Population

Latvia's population stood at an estimated 2.27 million at the beginning of 2008, representing a decline of 14.9 per cent since 1990. While a significant proportion of this decline is attributable to emigration by ethnic Russians following the collapse of the Soviet Union, falling birth rates and, since 2004, high levels of emigration to other EU member countries have also played a significant role. While Latvia's population is generally older than the European average, with 20.7 per cent of the population over the age of retirement, this proportion has been falling in recent years from its peak of 32.1 per cent in 2000. The Latvian population remains fairly rural by comparison to the European norm, with almost one-third of Latvians living in rural areas or small towns.

Minorities

As a result of mass deportations of ethnic Latvians and immigration of Russians and other eastern Slavs during the Soviet period, in 1989 ethnic Latvians comprised 52 per cent of the population. In the immediate aftermath of the breakup of the Soviet Union, approximately one-in-seven ethnic Russians living in Latvia returned to the Russian Federation, which increased the proportion of ethnic Latvians to around 60 per cent of the country's population. Since 2000, Latvia's ethnic mix has remained fairly constant, with around 60 per cent Latvian, 30 per cent Russian, 4 per cent Belarusian, 2.5 per cent each Ukrainian and Polish, and the balance split among a variety of ethnic and national minorities. As of end-2007, Latvians remain minorities in Riga and Latgale regions, in the capital city Riga, and in the major cities of Daugavpils, Rezekne and Jurmala.

Successive governments have pursued active and generally successful policies of naturalising non-ethnic Latvian residents. The pace of naturalisation accelerated rapidly in the late-1990s and particularly after Latvia joined the European Union in 2004. However, the pace of naturalisation slowed after the government adopted tighter language requirements in August 2006, and as of the start of 2007 approximately 18 per cent of Latvia's permanent residents were still not Latvian citizens. The government, with funding from the EU and US, continues to sponsor Latvian-language courses and programmes to assist resident aliens to learn Latvian. However, there remains considerable opposition to what these minorities perceive to be "forced Latvianisation," particularly among the native Russian-speaking populations in Latvia's larger urban centres.

Poverty

Latvia's strong economic growth and low levels of income inequality have resulted in relatively low levels of poverty. According to the World Bank's survey-based estimates, the poverty headcount rate (defined as the proportion of the population living on less than LVL 28 per month, in constant 1998 terms) has declined rapidly, from 19.4 per cent in 1998 to 5.9 per cent in 2004. While income inequality in Latvia seems to be increasing slowly, poverty is not anticipated to become a significant problem. However, poverty rates vary significantly by region, with areas like Latgale, Zemgale and Vidzeme having less than half of the level of per capita consumption and real GDP as Riga region. Rural poverty remains an issue of concern, particularly as growth in disposable incomes remains higher in urban than rural areas.

Education

Publicly funded compulsory education in Latvia lasts nine years, but students typically study for twelve years in primary and secondary education, along European lines. Despite the emphasis on education in the National Development Plan 2007-2013 and recent increases in budgetary allocations for public education, state schools remain under-funded and teachers poorly paid.However, according to the 2006 EBRD-World Bank Life in Transition Survey, the frequency of "unofficial payments" in the public education system are relatively low by regional standards, significantly lower than in Poland, the Czech Republic or Slovakia, but about twice as high as in Estonia. In addition, in 2005 Latvia had one of the highest levels of adult literacy in the world, at 99.7 per cent of the population above the age of 15, according to UNDP's 2007/2008 Human Development Report. Primary and secondary school enrolment is also high by transition country standards, at 90.2 per cent, placing Latvia 25th in the world on this indicator.

In addition to increasing public expenditure for education, the second key education reform challenge in Latvia concerns higher education, where attendance has almost trebled since independence, from 46,000 in 1991 to almost 130,000 in 2006/2007, while funding has seriously lagged. The tertiary education syllabus is in dire need of modernisation in order to increase the output of graduates trained in the sciences and technological and technical subjects such as engineering. As a part of its efforts to address this shortfall, the government has established several retraining programmes for the long-term unemployed. However, modernising the higher education curriculum and increasing funding for universities and research centres is urgently needed in order to maintain Latvia's competitiveness in human capital in the future.

Health

Health indicators declined precipitously in the early 1990s, in the wake of Latvia's economic collapse. Under-5 mortality – a good proxy for overall health – reached a peak of 21 deaths per 1,000 live births in 1995, before declining to 9.7 in 2005, according to the World Health Organisation (WHO). Life expectancy also fell sharply in the early 1990s but has since recovered: life expectancy for women, 76.8 years in 2006, is converging toward the EU mean. However, for Latvian men life expectancy remains low, at 65.9 years, largely attributable to continued high levels of alcohol consumption, which was higher in 2004 than in 1986.

Latvia's public healthcare system is overburdened and severely under-financed: healthcare expenditure of around four per cent of GDP is only half of the western European average. While the Latvian healthcare system has evolved rapidly from the Soviet mode – with a decline in the number of hospitals and hospital beds per capita – there has also been a significant per capita decline in the number of medical personnel, many of whom have emigrated to Western Europe. Private health insurance has been compulsory since 1998 but the development of private employers' insurance schemes remains at an early stage, and the State Healthcare Insurance Fund, financed through income tax, therefore remains the primary means of public health insurance.

Labour issues

Registered unemployment in Latvia reached its post-independence high of 10.2 per cent (according to ILO methodology) in April 1999. The unemployment rate fell steadily, to approximately 10 per cent at the end of 2004, and then dropped rapidly to 4.9 per cent at the end of 2007, well below the EU average. This steady decline and then rapid drop has been attributed to a combination of increasing employment opportunities presented by Latvia's rapid growth rate, followed by a rapid increase in emigration by primarily younger members of the workforce following Latvia's accession to the EU. While there are no official figures on the number of Latvians working abroad, the Bank of Latvia has recently estimated that around 70,000 Latvians – equivalent to approximately 6.0 per cent of the work force – are currently abroad. The labour market continues to suffer from structural imbalances, with falling demand for unskilled labour and increasing demand for highly skilled labour and professionals, while concerns remain about the ability of the Latvian educational system to supply the labour market's demands.

All workers – with the exception of the uniformed armed forces – are entitled by law to form and join trades unions, and approximately 20 per cent of the workforce is currently unionised, according to the annual country report for Latvia issued by the US State Department's Bureau of Democracy, Human Rights and Labour in March 2008. Child labour is strictly prohibited by Latvian law, and the State Department report concludes that the government "generally implemented these laws and policies in practice". The State Department report also reflected generally high standards of enforcement of both Latvian and European occupational health and safety standards, although it criticised the Latvian authorities for not enforcing the right of workers to remove themselves from dangerous work environment

ANNEX 6: OVERVIEW OF THE EBRD TC FUND AND OFFICIAL CO-FINANCING

Latvia – 1991/2007

Overview of the EBRD TC Fund and Official Co-financing

1. Aggregate TC Funds Commitment and Official co-financing signed projects;

2. Future scenario.

Appendix 1: Breakdown of TC Projects

Appendix 2: Breakdown of Official Co-financing (signed) projects

1. Aggregate TC Funds Commitment and Official co-financing signed projects;

- Since 1991, the Bank has been actively cooperating with multi and bilateral donors in the framework of both TC projects (for which aggregate commitments for the period 1991 - 2007 reached € 13.7 million) and Official co-financing initiatives (€ 142.8 million in signed projects as of end 2007).
- TC Funds: the Baltic Technical Assistance Fund (BTAF) and the EU provided the majority of funding for Latvia (EU €5.3 million, BTAF: €5.2 million), with Japan, Sweden and the UK also providing significant funding. The manufacturing sector (mostly through TAM and BAS projects) benefited from the largest part of TC funds (€5.1 million), followed by the Energy sector (€3.2 million). The most recent project to have been financed by TC in Latvia was to provide advice to the Latvian authorities on Concessions Law and PPPs, sponsored by Sweden.
- Official Co-financing: the largest official co-financers have been the EU and the EIB, for a total of €75.3 and €24.6 million respectively. The Japan Bank for International Cooperation has provided €16.4 million. Transport, municipal and environmental projects have received the majority of official co-financing.

TC FUNDS and Donors
Aggregate Commitments (1991- 2007): € 13.7 million

Annual Meeting Fund (Various)	361,428
Baltic Technical Assistance Fund	5,225,621
EU	5,313,143
Finland	266,221
Japan	768,327
Netherlands	121,274
Norway	15,681
Spain	145,190
Sweden	955,210
Taipei China	8,383
United Kingdom	529,036
Grand Total	**13,709,512**

Official Co-financing and Donors
Signed projects - Signing years: 1991-2007
€ 142.8 million

Baltic Investment Special Fund	3,401,144
European Commission	24,600,000
European Investment Bank	75,300,000
Japan Bank for International Cooperation	16,421,836
Ministry of the Environment Finland	4,682,956
Royal Ministry of Foreign Affairs Norway	400,000
Secretariat d'Etat a l'Economie Switzerland	8,414,946
Swedish International Development Cooperation Agency	9,599,833
Grand Total	**142,820,715**

2. Future scenario;

The main source of grant funding in support of projects investments in Latvia is linked with the utilisation of the EU Structural funds allocated under the "2007-2013 Entrepreneurship and Innovation" programme within the framework of the "Convergence" objective. The total budget of the programme is around € 1.08 billion.

The Operational Programme will promote, inter alia, the creation of new enterprises and will foster the development of existing companies, in particular in areas outside the capital city Riga. Besides Research and Technology Development (RTD), the programme puts emphasis on small and medium enterprises (SMEs) and revolving funds.

The programme will be implemented through four main priorities one of which ("Access to finance" seems relevant to the bank's activities. Assistance priorities are: Priority 1: Science and Innovation (60% of the OP resources) - Priority 2: Access to Finances (23% of the OP resources) - Priority 3: Promotion of Entrepreneurship (14% of the OP resources) - Priority 4: Technical assistance (3% of the OP resources) supports the management of the programme and communication activities.

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Breakdown of Finances by priority area

Priority area	Community Funding	National Public Funding	National Private Funding	Total Funding
Priority 1- Science and Innovation	440 982 000	77 820 353	100 690 000	619 492 353
Priority 2- Access to Finance	169 610 000	16 710 000	31 970 000	218 290 000
Priority 3- Promotion of Entrepreneurship	100 600 000	5 820 000	109 840 000	216 260 000
Priority 4- Technical assistance	25 538 950	4 506 874	0	30 045 824
TOTAL	736 730 950	104 857 227	242 500 000	1 084 088 177

Appendix 1: Breakdown of TC Projects

Donor	Commitment Name	Euro Committed	Euro Disbursed	Fund Approved Date	Status	Sector Type
Annual Meeting Fund (Various)	EBRD 2000 Annual General Meeting - Riga, Latvia	361,428	361,428	18/12/98	Closed	Community/Social Services
Baltic Technical Assistance Fund	Privatisation programme - accountancy advice	310,785	310,785	01/02/94	Closed	Community/Social Services
Baltic Technical Assistance Fund	Rigas Kommerc Banka (RKB) - operational and financial audit and due diligence	66,990	66,990	15/04/94	Closed	Finance, Business
Baltic Technical Assistance Fund	Baltic Investment Programme - training programme in feasibility studies for Latvia	172,388	172,388	15/04/94	Closed	Finance, Business
Baltic Technical Assistance Fund	TurnAround Management Programme - Juglas Manufaktura	49,997	49,997	15/04/94	Closed	Manufacturing
Baltic Technical Assistance Fund	Rigas Kommerc Banka (RKB) - preparation of medium-term strategy	35,000	35,000	15/05/94	Closed	Finance, Business
Baltic Technical Assistance Fund	Latvian Investment Bank - board representation	69,221	69,221	15/06/94	Closed	Finance, Business
Baltic Technical Assistance Fund	TurnAround Management Programme - LATVIJAS KERAMIKA	43,363	43,363	20/08/94	Closed	Community/Social Services
Baltic Technical Assistance Fund	TurnAround Management Programme - BALTIJA	53,542	53,542	20/09/94	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - REMUS	55,859	55,859	20/09/94	Closed	Community/Social Services
Baltic Technical Assistance Fund	TurnAround Management Programme - Grindex	58,289	58,289	20/11/94	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - Brivais Vilnis	49,777	49,777	20/11/94	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - LareLini	27,603	27,603	01/01/95	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - Livanu Stikls	44,170	44,170	01/03/95	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - Asote	42,003	42,003	01/03/95	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services - operating expenses for Riga	81,283	81,283	02/04/95	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services - subsidies disbursement	812,349	812,349	20/06/95	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services - local project director	10,498	10,498	20/07/95	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services - local project officer	6,989	6,989	25/08/95	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services - administrative secretary	5,225	5,225	20/09/95	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services - office equipment and furniture	24,248	24,248	20/09/95	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - Cezijs	17,365	17,365	10/10/95	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services - office lease for local Business Advisory Services office	60,713	60,713	10/10/95	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - Alfa	55,556	55,556	10/10/95	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services - project officer	14,194	14,194	16/05/96	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services - national fund director (extension of BTAF-95-07-23)	16,286	16,286	12/07/96	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - Velme	49,346	49,346	05/08/96	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services - administrative assistant	7,172	7,172	12/07/96	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - Tukums Dairy	47,690	47,690	18/09/96	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - Jana Seta	28,082	28,082	23/06/97	Closed	Manufacturing

Baltic Technical Assistance Fund	TurnAround Management Programme - Zunda III	34,718	34,718	06/10/97	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - Sparta Knitwear	47,089	47,089	05/02/98	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services - National Fund Director	4,620	4,620	10/03/98	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services - project officer	3,564	3,564	10/03/98	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services - Assistant to National Fund Director	2,112	2,112	10/03/98	Closed	Manufacturing
Baltic Technical Assistance Fund	Baltic Micro Business Advisory Services Programme - project officer	19,348	19,348	23/07/98	Closed	Manufacturing
Baltic Technical Assistance Fund	Baltic Micro Business Advisory Services Programme - subsidy account	552,742	552,742	23/07/98	Closed	Manufacturing
Baltic Technical Assistance Fund	Baltic Micro Business Advisory Services Programme - operating expenses	12,531	12,531	23/07/98	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - RBS Skal	59,903	59,903	07/12/98	Closed	Community/Social Services
Baltic Technical Assistance Fund	TurnAround Management Programme - Velme II	57,949	57,949	22/12/98	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - Jana Seta Printers	59,065	59,065	28/01/99	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - Remus Construction	60,000	60,000	29/01/99	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - JSC Lauma II	59,868	59,868	05/01/99	Closed	Manufacturing
Baltic Technical Assistance Fund	Turnaround Management Programme: AS Limbazu Piens	58,580	58,580	22/03/99	Closed	Manufacturing
Baltic Technical Assistance Fund	Turnaround Management Programme - Kvadra Pak	60,000	60,000	01/07/99	Closed	Manufacturing
Baltic Technical Assistance Fund	Turnaround Management Programme - Spilva SIA	57,755	57,755	21/07/99	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme (TAM) - SIA Simeks SMS Ltd	52,979	52,979	11/10/99	Closed	Manufacturing
Baltic Technical Assistance Fund	Micro-BAS Programme - Project Officer	16,476	16,476	16/12/99	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services (BAS) Programme - Subsidies	1,010,445	1,010,445	07/02/00	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme (TAM) - JSC Rebir II	59,711	59,711	15/02/00	Closed	Manufacturing
Baltic Technical Assistance Fund	Continuation TAM Programme in the Baltic States - SIA Firma Ave MTP	51,876	51,876	24/05/00	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme (TAM) - Cido Partikas Grupa	56,943	56,943	16/06/00	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme (TAM) - Resekne Piena Konservu Kombinats	52,170	52,170	19/06/00	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme (TAM) - A/S Preses Nams	60,000	60,000	24/07/00	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme (TAM) - JSC Lindeks	53,292	53,292	02/08/00	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme (TAM) - Kvadra Pak II	59,931	59,931	07/08/00	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - JSC Lauda	56,170	56,170	15/08/00	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme - AS Dobeles Dzirnavnieks	18,228	18,228	08/09/00	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme (TAM) - Reaton Ltd	59,851	59,851	31/10/00	Closed	Manufacturing
Baltic Technical Assistance Fund	Business Advisory Services - Aigars Strautins, Project Officer	19,990	19,990	07/12/00	Closed	Manufacturing
Baltic Technical Assistance Fund	TurnAround Management Programme (TAM) - Langa SIA	59,700	59,700	16/02/01	Closed	Manufacturing
Baltic Technical Assistance Fund	TAM Programme - Spilva II	59,853	59,853	14/08/01	Closed	Manufacturing
Baltic Technical Assistance Fund	RAF Avia Financial 3	12,182	12,182	08/08/03	Closed	Finance, Business
EU	TurnAround Management Programme - advisory services contract - OlainePharm	49,996	49,996	01/10/95	Closed	Community/Social Services

EU	TurnAround Management Programme - advisory services contract - Valmeira Glass Factory	49,355	49,355	01/10/95	Closed	Manufacturing
EU	TurnAround Management Programme - advisory services contract - Aurora	32,646	32,646	01/11/95	Closed	Community/Social Services
EU	TurnAround Management Programme - advisory services contract - Grindex	48,663	48,663	01/11/95	Closed	Community/Social Services
EU	TurnAround Management Programme - advisory services contract - REF	44,648	44,648	01/01/96	Closed	Manufacturing
EU	TurnAround Management Programme - advisory services contract - JSC Lauma	79,821	79,821	01/03/96	Closed	Manufacturing
EU	TurnAround Management Programme - advisory services contract - Zunda training	50,000	50,000	01/04/96	Closed	Community/Social Services
EU	TurnAround Management Programme - advisory services contract - REMUS training	48,253	48,253	01/04/96	Closed	Community/Social Services
EU	TurnAround Management Programme - advisory services contract - Laima training	41,370	41,370	01/04/96	Closed	Community/Social Services
EU	TurnAround Management Programme - advisory services contract - ROG	41,198	41,198	01/04/96	Closed	Community/Social Services
EU	TurnAround Management Programme - Spodriba	49,823	49,823	01/06/96	Closed	Community/Social Services
EU	TurnAround Management Programme - advisory services contract - JSC Lauma training	48,468	48,468	01/06/96	Closed	Community/Social Services
EU	TurnAround Management Programme - Uzvara	44,629	44,629	01/06/96	Closed	Community/Social Services
EU	TurnAround Management Programme - Kaija	45,561	45,561	01/07/96	Closed	Community/Social Services
EU	TurnAround Management Programme - advisory services contract - GSM	47,261	47,261	01/07/96	Closed	Community/Social Services
EU	TurnAround Management Programme - advisory services contract - Brivais Vilnis	46,842	46,842	01/08/96	Closed	Manufacturing
EU	TurnAround Management Programme - advisory services contract - Tartu Instruments	34,929	34,929	01/08/96	Closed	Manufacturing
EU	TurnAround Management Programme - advisory services contract - Latvijas Udensceli	9,039	9,039	01/08/96	Closed	Community/Social Services
EU	TurnAround Management Programme - Livanu Stikls	68,809	68,809	01/09/96	Closed	Community/Social Services
EU	TurnAround Management Programme - advisory services contract - CS Turiba	46,540	46,540	01/11/96	Closed	Community/Social Services
EU	TurnAround Management Programme - advisory services contract - Rigas Vagonu Rupnica	29,292	29,292	01/02/97	Closed	Community/Social Services
EU	TurnAround Management Programme - Jelgava Sugar	59,810	59,810	01/02/97	Closed	Community/Social Services
EU	TurnAround Management Programme - advisory services contract - Kometa	47,765	47,765	01/02/97	Closed	Community/Social Services
EU	TurnAround Management Programme - Rita	50,000	50,000	01/02/97	Closed	Community/Social Services
EU	TurnAround Management Programme - advisory services contract - Latvijas Keramika	49,310	49,310	01/03/97	Closed	Manufacturing
EU	TurnAround Management Programme - advisory services contract - Batlija Furniture	44,746	44,746	01/03/97	Closed	Manufacturing
EU	TurnAround Management Programme - advisory services contract - JSC Starburadze	47,435	47,435	01/04/97	Closed	Community/Social Services
EU	TurnAround Management Programme - advisory services contract - JSC Dzintars	26,125	26,125	01/05/97	Closed	Community/Social Services
EU	TurnAround Management Programme - Kaija	48,454	48,454	21/07/97	Closed	Community/Social Services
EU	TurnAround Management Programme - Jana Seta (II)	81,919	81,919	06/02/98	Closed	Community/Social Services
EU	TurnAround Management Programme - JSC Olaine chemical	37,688	37,688	06/02/98	Closed	Community/Social Services
EU	TurnAround Management Programme - AS Rebir	33,989	33,989	19/03/98	Closed	Community/Social Services
EU	TurnAround Management Programme - Baltic Dairy Corporation	43,806	43,806	05/05/98	Closed	Community/Social Services
EU	TurnAround Management Programme - Teika Mebelu Fabrika	48,200	48,200	08/05/98	Closed	Community/Social Services
EU	TurnAround Management Programme - Ogre II	21,412	21,412	06/05/98	Closed	Community/Social Services
EU	TurnAround Management Programme - JSC Staburadze	55,457	55,457	17/06/98	Closed	Community/Social Services

EU	TurnAround Management Programme - Rita	41,066	41,066	17/06/98	Closed	Community/Social Services
EU	TurnAround Management Programme - JSC Dzintars	16,347	16,347	18/06/98	Closed	Community/Social Services
EU	Energy sector emergency investment programme - project management unit	328,786	328,786	20/12/92	Closed	Energy
EU	Energy sector emergency investment programme - energy emergency planning group	173,952	173,952	20/12/92	Closed	Energy
EU	Energy sector emergency investment programme - commercial accounting systems for main energy utilities	481,764	481,764	20/12/92	Closed	Energy
EU	Energy sector emergency investment programme - energy conservation awareness campaign	189,000	189,000	20/12/92	Closed	Energy
EU	Energy sector emergency investment programme - wood harvest, distribution and conversion study	183,950	183,950	20/12/92	Closed	Energy
EU	Privatisation programme - privatisation advice	584,496	584,496	03/02/94	Closed	Community/Social Services
EU	Latvenergo recapitalisation - financial advice	464,802	464,802	04/11/94	Closed	Energy
EU	Post-privatisation Fund (Latvia / Lithuania) fund investment portfolio - investment development and implementation	963,816	963,816	02/01/96	Closed	Non-classifiable Establishments
EU	BAS Programme in the Baltics	231,904	231,904	08/12/00	Closed	Manufacturing
Finland	Energy operations - technical adviser	81,911	81,911	27/03/96	Closed	Energy
Finland	PAS Gutta Baltic juice manufacturer	139,943	139,943	26/06/98	Closed	Manufacturing
Finland	Baltic Pulp Mill Company - Project Advisor to the Government of Latvia	44,367	44,367	22/02/01	Closed	Agriculture, Forestry, Fishing
Netherlands	Pirma Latvijas Komercbanka twinning programme	121,274	121,274	10/11/97	Closed	Finance, Business
Japan	Daugava river hydropower plants - technical and economic feasibility	749,361	749,361	01/12/93	Closed	Energy
Japan	Project Evaluation Department's special evaluation of the Latvia energy sector emergency investment project	18,966	18,966	18/12/97	Closed	Community/Social Services
Norway	Transport project preparation/environment	9,917	9,917	01/11/93	Closed	Transport, Storage
Norway	Latvian banking sector - Bank Baltija	5,764	5,764	01/07/95	Closed	Finance, Business
Spain	Latvia: Feasibility Study for potential PPP projects in road sector	145,190	139,759	15/11/05	Disbursing	Construction
Sweden	Baltic Sea environmental programme (Phase II) - forestry sector restructuring	9,063	9,063	01/09/92	Closed	Agriculture, Forestry, Fishing
Sweden	Refurbishment of Andrejsala Co-generation Plant - Phase I - pre-feasibility study	223,593	223,593	28/01/93	Closed	Energy
Sweden	Construction management for heavy fuel oil import facilities	246,768	246,768	28/01/93	Closed	Transport, Storage
Sweden	Forestry sector Master Plan - supervisory assistance	20,961	20,961	01/07/93	Closed	Agriculture, Forestry, Fishing
Sweden	Energy emergency investment programme - procurement advicer	138,008	138,008	09/07/93	Closed	Energy
Sweden	Pirma Banka - Work-out Expert	67,916	67,916	04/02/00	Closed	Finance, Business
Sweden	Latvia Hydropower Dam Safety Act	199,000	199,000	29/11/01	Closed	Energy
Sweden	Latvia: Concessions/PPP Law Development advice	49,900	49,900	29/04/05	Closed	Community/Social Services
Taipei China	Transport project preparation - economic evaluation	8,383	8,383	01/10/93	Closed	Transport, Storage
United Kingdom	Latvian Shipping Company - legal advice	84,398	84,398	13/05/94	Closed	Transport, Storage
United Kingdom	Latvian Shipping Company - privatisation advice	180,190	180,190	13/05/94	Closed	Transport, Storage
United Kingdom	Privatisation programme - legal advice	181,360	181,360	01/07/94	Closed	Community/Social Services
United Kingdom	Assistance in Reform of Legislation on Secured Transactions	46,418	46,418	09/05/97	Closed	Community/Social Services
United Kingdom	AS Lauma project preparation	36,671	36,671	27/05/99	Closed	Manufacturing
	Report Total Euro Amount:	**13,709,512**	**13,704,081**			
	No of Commitments:	**133**				

Appendix 2: Breakdown of Official Co-financing (signed) projects

Op Name	Signing Year	Organisation Name	Country	Finance type	EUR Amount
Investment Bank of Latvia (equity)	1994	Baltic Investment Special Fund	UNITED KINGDOM	Participation	1,380,488
				Total:	**1,380,488**
Daugava Hydro Schemes Upgrade Project	1996	European Investment Bank	LUXEMBOURG	IFI Loan	6,000,000
	1996	Japan Bank for International Cooperation	JAPAN	Parallel Loan	12,572,968
	1996	Royal Ministry of Foreign Affairs	NORWAY	Grant	400,000
				Total:	**18,972,968**
Riga Environment Project	1996	European Investment Bank	LUXEMBOURG	IFI Loan	15,000,000
	1996	Secretariat d'Etat a l'Economie	SWITZERLAND	Grant	3,014,946
	1996	Swedish International Development Cooperation Agency	SWEDEN	Grant	3,399,833
	1996	Ministry of the Environment	FINLAND	Grant	1,282,956
				Total:	**22,697,736**
Road Project - Latvia	1994	Japan Bank for International Cooperation	JAPAN	Parallel Loan	3,848,868
				Total:	**3,848,868**
Hansabanka (Formerly Latvijas Zemes Banka)	1997	Baltic Investment Special Fund	UNITED KINGDOM	Participation	2,020,656
				Total:	**2,020,656**
Ventspils Port Rail Terminal Project	1998	European Investment Bank	LUXEMBOURG	IFI Loan	34,300,000
	1998	European Commission	BELGIUM	Grant	7,600,000
				Total:	**41,900,000**
Riga Water Company Corporate Loan	2000	European Investment Bank	LUXEMBOURG	IFI Loan	20,000,000
	2000	European Commission	BELGIUM	Grant	17,000,000
	2000	Secretariat d'Etat a l'Economie	SWITZERLAND	Grant	5,400,000
	2000	Swedish International Development Cooperation Agency	SWEDEN	Grant	6,200,000
	2000	Ministry of the Environment	FINLAND	Grant	3,400,000
				Total:	**52,000,000**
				Country Total:	**142,820,715**

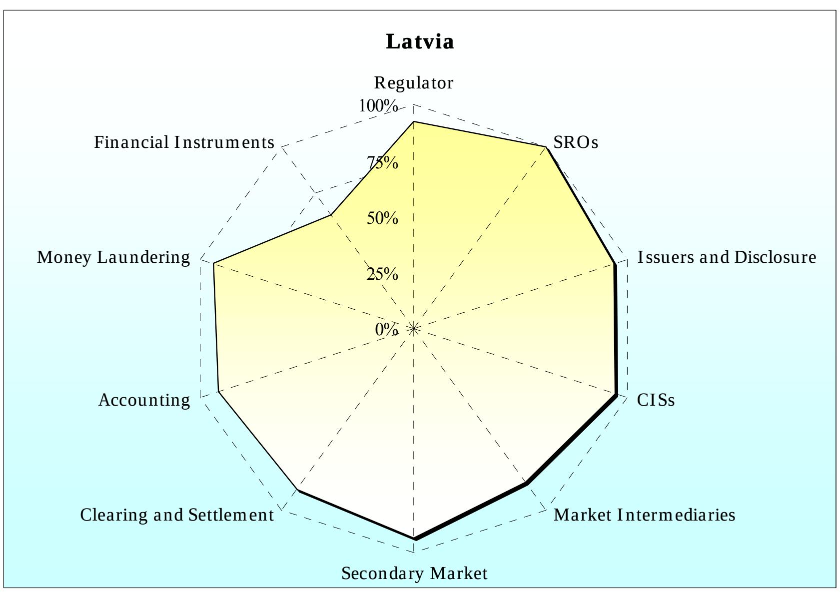
ANNEX 7: ASSESSMENT OF LATVIA'S COMMERCIAL LAWS

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 such 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

In Latvia the basic legislation on the securities markets is contained in the Financial Instruments Market Law (FIML), in force since January 2004. The FIML regulates the issuing of securities, takeovers of public companies, investment services, the activities of the stock exchange and the securities depositary. Separate legislation exists for pension funds and collective investment funds. The securities markets legal framework was most recently amended in 2007 when new regulations on indirect holdings, notification of significant shareholdings and reporting obligations of listed companies were introduced. Further amendments for the implementation of the "Market in Financial Instruments Directive" (so-called MiFiD) were adopted in October 2007. The securities markets regulator is the Finance and Capital Market Commission, which is also responsible for banking, insurance and pension fund regulation.

Quality of securities markets legislation – Latvia (2007)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IOSCO's *Objectives and Principles for Securities Regulations*. The fuller the 'web', the closer the relevant securities market legislation of the country approximates these principles.

Source: EBRD Securities Market Legislation Assessment 2007

The 2007 EBRD Securities Markets Legislation Assessment (see chart above), found Latvia in "high compliance" with the Objectives and Principles of Securities Regulation published by the International Organization of Securities Commissions (IOSCO) showing only minor weaknesses in the legislation on bonds.

In order to understand how securities market legislation works in practice, the EBRD recently concluded the 2007 Legal Indicator Survey ("the LIS"). Practitioners in the region were asked to comment on a hypothetical case study, advising an investor who lost his savings after buying shares in a national company's Initial Public Offering (IPO), misled by erroneous information in the prospectus. In particular, the Survey concentrated on effectiveness of prospectus disclosure requirements, private and public enforcement mechanisms and authority of the market regulator.

The LIS revealed that although IPOs in Latvia are seldom used as a source of funding, disclosure practice follows relatively good standards. The documentation included in the prospectus is considered reliable and financial reporting practices sound. EC Regulation 809/2004 directly applies detailed disclosure requirements and is reported to be well implemented. Private enforcement mechanisms (i.e. legal action before a court) show some weaknesses as procedures might be complex and characterised by heavy burdens of proof. When looking at public enforcement mechanisms, the Survey revealed that the regulator is developing expertise in investigating complex securities cases but the corresponding capacity of prosecutor remains low.

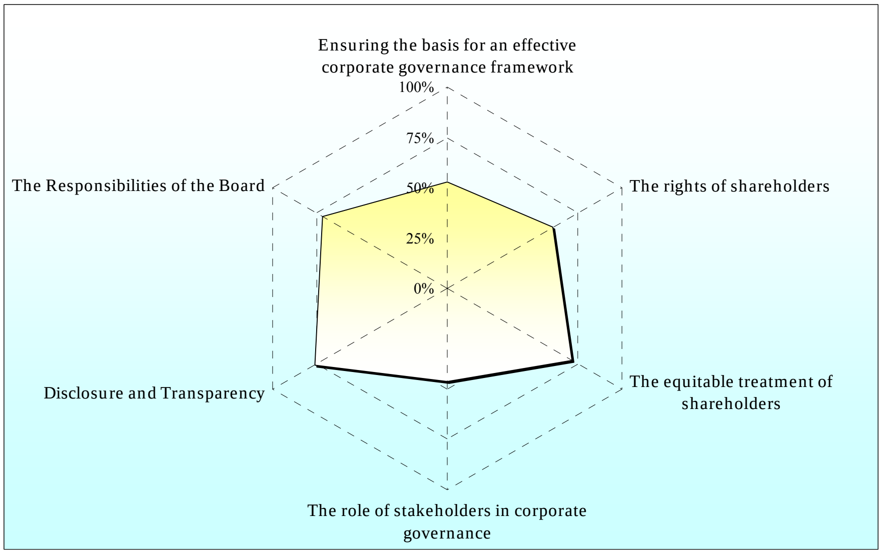
Company Law and Corporate Governance

The main legislation governing corporate governance in Latvia is contained in the Commercial Law (enacted in 2000 and amended last in 2006) and the Financial Instruments Market Law (enacted in 2004 and amended last in 2007).

A voluntary corporate governance code (the "Corporate Governance Principles and Recommendations for their Implementation") has been developed by the Riga Stock Exchange in 2005. Listed companies are required to comply with the Principles or to explain the reasons for their non-compliance (so-called "comply or explain" mechanism).

According to the preliminary results of the EBRD's 2007 Corporate Governance Sector Assessment, under which the quality of corporate governance legislation in force in November 2007 was assessed, Latvia showed a good level of compliance with the relevant international standards (the OECD Principles of Corporate Governance), but with some shortcomings (see chart below). In particular the mechanisms for ensuring the basis for an effective corporate governance framework and the role of stakeholders in corporate governance need to be improved.

Quality of corporate governance legislation – Latvia (2007)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles

Source: EBRD Corporate Governance Sector Assessment, 2007

In 2005, the EBRD launched a survey for testing how the corporate governance legislation 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 revealed a series of problems, in particular concerning the time possibly needed to conclude the proceedings (it is reported easy for the defendant to delay the procedure) and the institutional environment (courts and prosecutors are not well experienced in complex corporate cases, there is little case law available offering guidance on interpretation, statutory auditors – especially in smaller companies - are not independent from the management).

Concessions

Latvia adopted their PPP Policy Framework first in 2002 and then in 2005 and developed a PPP Action Plan, due to be finalised in 2009. The tasks in the Action Plan include establishing adequate institutional set-up for PPP's and promotion framework, legal framework, PPP's interaction with national planning instruments and effective dissemination of knowledge on PPP, largely undertaken by Latvian Investment and Development Agency in cooperation with the Ministry of Economy The Action Plan further provides for the drafting a new and more detailed Concessions Law, which has already been done (with the EBRD's assistance; this law has been approved in the second out of the three hearings at the Parliament). The Action Plan also provides for drafting of government regulations on PPP in accordance with the EU directives.

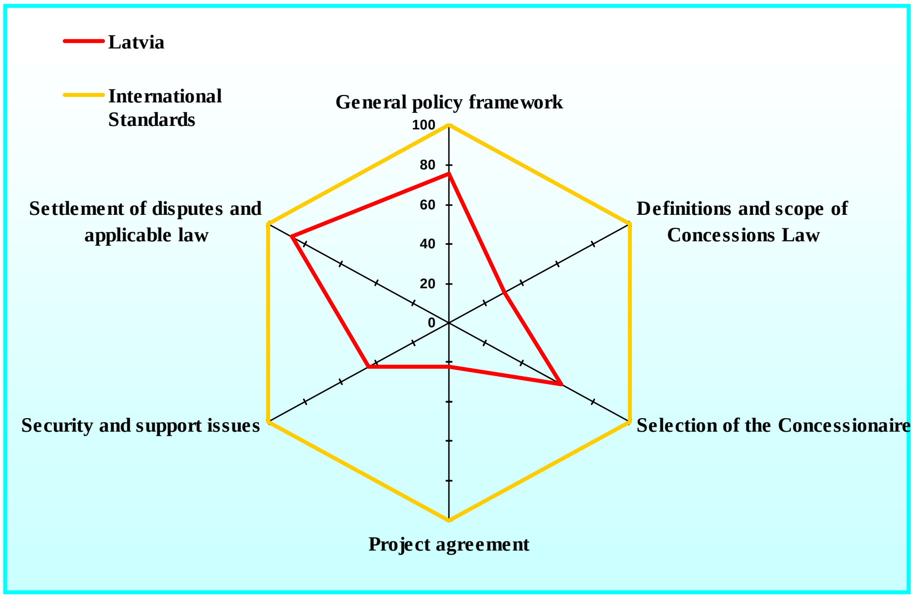
The current Latvian Concession Law was adopted in 2000 (the "Law"). The Law is too general as far as the majority of Core Areas are concerned. Its scope of application needed to be improved (the Law seems to narrowly limit its application to agreements entitled "concession" only and vaguely identifies the sectors/types of infrastructure/services). The selection procedure also needed to be specified (no reference to the possibility of a pre-selection procedure; unsolicited proposals and direct negotiations not regulated). Many issues in the project agreement are to be included in "conditions for granting concessions" (e.g. termination, tariffs), and it is unclear whether such conditions can be negotiated or not. The Law is rather restrictive as far as financial securities are concerned (e.g. prohibition of pledge of concession resources). On a positive note, however, as far as government support issues are concerned, the Law refers to the "guarantees of a conceder to a concessionaire regarding financial and commercial risks" to be provided in "conditions for granting concession", and to the Law on the Control over State and Local Government Aid Provided for Commercial Activity which provides for different types of government support.

The Law required improvements in order to constitute a sufficiently solid legal basis for the development of PPP in the infrastructure and utility services in Latvia, hence the new Concessions Law plans underway.

Amendments to the Law on the Control of State and Local Government Aid Provided for Commercial Activity are also under consideration. Both of the draft laws have been before the Parliament for quite some time, however the dates of their final approval and enactment are somewhat unpredictable.

The 2007/8 EBRD Assessment of Concession Laws undertaken to evaluate applicable regimes throughout the EBRD countries of operations (the laws on the books only rather than how they work in practice), revealed that current Latvian laws had "medium compliance" with internationally accepted standards in this sector. As can be seen from the spider graph below, project agreement, security rules as well as definitions and the scope of law are areas mostly in need of being upgraded.

Quality of concession legislation – Latvia (2007/8)



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 2007/8

Insolvency

Latvia adopted a new Law on Insolvency (the "new Law") at the end of 2007, which entered into force on 1 January 2008. The new Law is meant to replace the old Insolvency Act of 1996 that was regarded as outdated and containing many gaps.

The new law addresses the existing gaps in the insolvency primary legislation, at the same time introducing legal novelties into the framework. Among the most significant changes to the established system is the regulation of insolvency of individuals, allowing individuals to file for bankruptcy.

In addition, a separate Insolvency Register has been introduced where companies subject to insolvency proceedings shall be registered together with the status of such proceedings. The criteria for a company to be considered insolvent have also changed, now providing for five detailed criteria of insolvency based on the debtor's payment capacity. The supervisory role for implementation of the Law was vested in the Insolvency Agency which is also in charge of controlling the activity of insolvency administrators.

The new Law emphasises the role of the insolvency administrator entrusting him with a range of key powers during the insolvency proceedings, including the decision on acceptance of creditors' claims. The new Law provides certain safeguards to ensure the administrator's proper fulfilment of his obligations. These include sophisticated requirements for obtaining a license, mandatory training, and mandatory liability insurance that the administrator must hold against any losses caused by his actions.

The new Law appears to place an emphasis on measures for revival of a company. The law provides for a stage preceding insolvency – legal protection proceedings. The debtor may seek application of this measure which has as main effect a temporary stay of payments for most liabilities of the company to allow it to stabilise its payment ability. Moreover, the insolvency proceedings include the settlement, recovery and bankruptcy stages. These first two stages, again, aim to allow the company to recover, either by negotiating and settling the payments with its creditors, or by coming up with a recovery plan (this includes the reorganisation plan). Any of these measures would need to be approved by the creditors and the court in order to go ahead.

In case of liquidation, the default method for realisation of assets is by public auction. The law is not quite clear in which circumstances the auction can be avoided. This has the potential for making the realisation process unreasonably rigid.

The new Law appears to be of good quality despite the tendency to over detail some procedures and an abundance of cross-references to specific articles in other laws.

Secured Transactions

Secured transactions law in Latvia underwent reform 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 may only grant a commercial pledge on vehicles, aircraft, an enterprise as a pool of assets, and shares in companies and bonds – this restriction is mostly designed to avoid the commercial pledge being 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.

As far as mortgages are concerned, the Civil Code governs the creation, registration and enforcement of the security right. Mortgages are registered with the Land Register departments of the regional courts. The database is centralised and fully electronic, and can be searched freely via the Internet. In case of mortgagor default, the mortgage can only be enforced by a public auction led by a court's bailiff based on a court's decision or based on the authorisation expressly given in the mortgage agreement or another agreement concluded with the owner consequently. Enforcement is reported to work efficiently. Difficulties may arise with eviction as occupants can be evicted only based on a court's decision if agreed in the mortgage agreement.

Generally speaking, the legal framework serves the country's needs well. There are however a few areas of uncertainty or complexity:

- The commercial pledge 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. The same problem of delay exists for mortgages registration.
- Expressing the secured debt in foreign currency for both pledges and mortgages, because the amount secured is the LVL amount that must be shown in the Register.
- The cost of enforcing a mortgage is quite high.

Telecommunications

The communications sector in Latvia is currently governed by the Law on Electronic Communications of 2004 (the "2004 Communications Law"), as amended in 2007. Market regulation is the responsibility of the Public Utilities Commission (SPRK) and the Ministry of Transport is responsible for sector policymaking. The 2004 Communications Law (and related regulations and amendments) transposed the 2002 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 2004 Electronic Communications Law, SPRK continues to supervise the market whilst the Electronic Communications Agency (functionally and institutionally supervised by the Ministry of Transport) deals with radio frequency spectrum and numbering resources.

In 1993, a Sonera-led consortium (Tilts) took a 49% stake in Lattelecom. The remaining 51% continues to be held by the state. TeliaSonera (as Sonera became) has since made efforts to increase its interest in Lattelecom, but has been met with reluctance on the part of the government which fears a negative impact on competition if TeliaSonera were to acquire controlling or full ownership.

The mobile market is shared by one CDMA (Telekom Baltija) and three GSM (LMT, Tele2 and Bite) mobile network operators. A number of Mobile Virtual Network Operators (MVNOs) also offer services. LMT and Tele2 also hold 3G licences. Mobile teledensity is currently significantly above 100% (reported to be approx. 140%). While a third GSM operator entered the market in 2005, it remains effectively a duopoly between LMT and Tele2, with these operators controlling most of the market. Though the launch of mobile number portability (MNP) in 2005 (albeit pre-pay MNP was delayed until 2008) and entry of MVNOs had been expected to lead to increased competition, this has yet to happen. The maturity of the mobile market leaves little scope for significant change in make up of the sub-sector, though the recent introduction of MNP for pre-paid customers could impact.

At the beginning of 2008 the broadband density rate stood at 15%. Though this rate remains below the current European Union (EU) average of 20%, annual growth has been in close to 300% since 2006.

In line with membership obligations of both EU and WTO, Latvia has adopted almost all regulatory reforms necessary to harmonise the electronic communications framework. Some minor issues remain with respect to transposition of elements of the EU framework, which the European Commission have pursued through infringement proceedings. Overall, positive development continues in the sector in Latvia as competition continues to take hold with a resultant drop in retail prices.