EUROPEAN
COMMISSION

Brussels, 29.5.2013
SWD(2013) 364 final

COMMISSION STAFF WORKING DOCUMENT

Assessment of the 2013 national reform programme and convergence programme for LATVIA

Accompanying the document

Recommendation for a Council Recommendation

on Latvia's 2013 national reform programme and delivering a Council Opinion on Latvia's 2013 convergence programme for 2012-2016

{COM(2013) 364 final}

CONTENTS

EXECUTIVE SUMMARY

Economic outlook

In 2012, the Latvian economy was by far the fastest growing in the EU at 5.6%. According to the Commission's spring 2013 forecast, growth is expected to slow to 3.8% in 2013 and 4.1% in 2014, but the country is still set to remain among the best performers in Europe. Unemployment is expected to drop to 13.7% in 2013 and to 12.2% in 2014 (from 14.9% in 2012). Meanwhile, inflation slowed to 2.3% in 2012, and is expected to fall to 1.4% in 2013 and 2.1% in 2014.

Latvia’s public finances are improving. The headline budget deficit fell to 1.2% of GDP in 2012, which means Latvia has corrected its excessive deficit within the agreed deadline. The deficit is predicted to remain at 1.2% of GDP in 2013 and fall to 0.9% in 2014. However, after declining to 0.3% of GDP in 2012, the structural deficit (net of the impact of the cycle and one-off and temporary measures) is expected to increase to 1.4% in 2013 and to 1.5% in 2014, according to the Commission, on the back of the pension reform and planned tax cuts. Latvia's medium-term objective is a structural deficit of 0.5% of GDP. Government debt is expected to remain well below the 60% of GDP limit, falling from 40.7% of GDP in 2012 to 40.1% in 2014.

Key issues

In 2012, the Latvian economy was by far the fastest growing in the EU. Though high economic growth is expected to slow, the country is still set to remain among the best performers in Europe. Latvia has asked the Commission and the European Central Bank for a convergence assessment in view of adopting the euro from January 2014.

Latvia has made some progress with regard to the 2012 CSRs, and the prospects for future implementation are encouraging. The budgetary situation improved considerably in 2012, as the headline deficit declined to 1.2% of GDP and the structural deficit to 0.3% of GDP, allowing Latvia to correct its excessive deficit by the deadline and to reach its medium-term budgetary objective ahead of earlier plans. The adoption of the Fiscal Discipline Law is welcome, and the proposed reforms in the education and science sectors respond well to the challenges identified by the Commission, though implementation will be difficult. The liberalisation of the electricity market is a positive step, though further action is needed to prepare for the opening of the gas market and improve energy efficiency.

In the medium- to long term, Latvia faces a number of challenges, in particular to maintain sound fiscal policy and reduce the size of the shadow economy. Other challenges relate to the quality of vocational education, social assistance, R&D spending and innovation performance, energy and the efficiency of the judiciary. European structural funds for 2014-2020 will provide an important source of public investment to support Latvia in meeting these challenges.

- **Labour market**: Youth unemployment (at 28% in 2012) is the seventh highest in the EU, and young people are overrepresented among emigrants. Long-term unemployment stands at 7.8% of the active population, significantly above the EU average of 4.6%. There are concerns that vocational education and training is failing to provide sufficient skills for the workforce, with shortages of qualified candidates in ICT, pharmaceuticals and engineering.

- **Poverty**: The major challenge in Latvia is that 40% of the population is at risk of poverty or social exclusion, and little direct action has been taken on this front in the last year. Unemployed people and families with children are particularly vulnerable, as social benefits are poorly targeted, with a large share going to the wealthiest people. There are high disparities across local governments in providing social assistance and weak incentives to for social benefit recipients to go back to work.

- **Research**: Latvia's challenge is to rationalise and modernise research activities, keep highly-qualified scientists at home in the face of international competition, and increase the number of new doctorates awarded. Latvia has the lowest business R&D intensity in the EU (0.19% of GDP in 2011) and there is little R&D investment by domestic or foreign companies to support specialisation in innovation-driven sectors.

- **Energy**: Crucial gas infrastructures – including the LNG terminal project and the renegotiation of the Incukalns gas storage contract – need to be put in place, while negotiations with Russia and Belarus on the creation of a Baltic regional electricity market are key. Latvia's energy and carbon intensity is more than double the EU average (particularly in households and the transport sector). The implementation of EU-funded housing insulation projects has been a big challenge, and transport measures do not seem to have had a significant effect.

1. INTRODUCTION

In May 2012, the Commission proposed a set of country-specific recommendations (CSRs) for economic and structural reform policies in Latvia. On the basis of these recommendations, the Council of the European Union adopted seven CSRs in the form of a Council Recommendation in July 2012. These CSRs concerned public finances, taxation, the labour market, poverty and social exclusion, energy networks and efficiency, the judiciary, and higher education and science. This Staff Working Document (SWD) assesses the state of implementation of these recommendations in Latvia.

The SWD assesses policy measures in light of the findings of the Commission's Annual Growth Survey 2013 (AGS)[1] and the second annual Alert Mechanism Report (AMR)[2], which were published in November 2012. The AGS sets out the Commission's proposals for building the necessary common understanding about priorities for action at national and EU level in 2013. It identifies five priorities to guide Member States to renewed growth: pursuing differentiated, growth-friendly fiscal consolidation; restoring normal lending to the economy; promoting growth and competitiveness for today and tomorrow; tackling unemployment and the social consequences of the crisis; and modernising public administration. The AMR serves as an initial screening device to determine whether macroeconomic imbalances exist or risk emerging in Member States. The AMR found positive signs that macroeconomic imbalances in Europe are being corrected. To ensure that a complete and durable rebalancing is achieved, 14 Member States were selected for a review of developments in the accumulation and unwinding of imbalances.[3]

Against the background of the 2012 Council Recommendations and the AGS, Latvia presented updates of its national reform programme (NRP) on 2 May 2013 and of its convergence programme for 2013-2016 on 29 April 2013. These programmes provide detailed information on progress made since July 2012 and on the government's future plans. The information contained in these programmes provides the basis for the assessment made in this SWD. The programmes submitted went through an inclusive consultation process involving the national parliament, local and regional authorities and other stakeholders. Compared to previous years, the quality of submitted programmes has greatly improved.

Overall assessment

The analysis in this SWD leads to the conclusion that Latvia has made some progress on measures taken to address the CSRs in the Council Recommendation. In addition, prospects for future implementation appear to be encouraging, and are primarily supported by better policy-making and broad support for reforms. An exception is the reform of the social assistance system, where ambitious reforms are needed to address poverty and social exclusion. The budgetary situation improved considerably in 2012, with Latvia reaching its medium-term budgetary objective (MTO), and fiscal governance has been strengthened with the adoption of the Fiscal Discipline Law. The tax measures announced by the authorities, while going in the right direction, did not, however, sufficiently address low income earners, and no compensatory tax measures were announced. The proposed reforms in the education

[1] COM(2012) 750 final.
[2] COM(2012) 751 final.
[3] 13 in-depth reviews were published on 10 April 2013. While selected for an in-depth review in the 2012 AMR, Cyprus was ultimately not reviewed under the MIP in view of the advanced preparations for a financial assistance programme.

and science sectors respond well to the challenges identified by the Commission, though implementation will be difficult. Liberalisation of the electricity market is a positive step, though further action is needed to prepare for the opening of the gas market, improve energy efficiency performance and implement a stable, transparent and cost-effective support scheme for renewable energy. Further efforts are needed to expand the reach of active labour market policies (ALMPs) to address high long-term and youth unemployment, continue to make improvements in judicial procedures and the Insolvency Law, and to implement credible public administration reforms. Regrettably, decision-making procedures regarding key structural reforms appear to be long, in particular as regards reviewing important legal texts by the Parliament.

The policy plans submitted by Latvia address most of the challenges identified in last year's SWD, and broad coherence between the two documents has been ensured. The NRP confirms Latvia's commitment to address shortcomings in the areas of labour market, higher and vocational education and science, energy efficiency and judicial reforms. The convergence programme demonstrates Latvia's commitment to maintain a structural budgetary position which is based on the MTO, with any deviation limited to the incremental impact of systemic pension reform. Sometimes, however, planned measures do not address the challenges in a comprehensive way, in particular as regards improvements in social assistance to address poverty and social exclusion.

2. ECONOMIC DEVELOPMENTS AND CHALLENGES

2.1. Recent economic developments and outlook

Recent economic developments

The Latvian economy continued to recover at a rapid pace in 2012, despite adverse external shocks. The growth rate of 5.6% in 2012 was the highest in the EU and followed an equally strong economic expansion of 5.5% in 2011. Investments, exports and private consumption were major growth drivers on the demand side, while construction and manufacturing were the fastest growing supply components of GDP. An exceptionally good agricultural crop and favourable weather conditions also supported economic growth in 2012. Meanwhile, inflation (harmonised index of consumer prices or HICP) slowed to a year-average of 2.3% and decreased further to a record low of 0.3% year-on-year in March 2013, helped by a steady decline in non-energy industrial goods, some downward corrections to prices of energy imports, and VAT cut from 22% to 21% as of July 2012.

The strong economic growth brought substantial improvements to the labour market. Employment rose by 2.8% in 2012 and the labour force expanded by 1.3% over the same period amid a significant decline in net emigration. Accordingly, the unemployment rate dropped from 16.2% in 2011 to 14.9% in 2012 and 13.8% in the last quarter of the year.

In the external sector, the current account deficit contracted to 1.7% of GDP in 2012. The deficit was well covered by net inflows of foreign direct investment, which reached 2.9% of GDP, as well as large net inflows in the capital account (3% of GDP), linked mostly to EU Structural Funds and the Cohesion Fund. In effect, the country’s net external debt dropped further to 38.1% of GDP at the end of 2012, from 46.4% a year earlier.

Economic outlook

The Commission's latest economic sentiment indicator and the 2013 spring forecast confirm a broadly favourable economic outlook for Latvia. Despite some slowdown, the country's economic growth is forecast to remain among the highest in the EU, at 3.8% in 2013 and 4.1% in 2014. Inflation (HICP) is set to remain low, at 1.4% in 2013 and 2.1% in 2014, while unemployment is expected to slide further, to 13.7% in 2013 and 12.2% in 2014. The current account deficit is projected to widen gradually to 2.1% of GDP in 2013 and 2.6% in 2014, but non-debt inflows in the capital and financial accounts are expected to contribute to a further reduction of the country's external indebtedness.

The economic outlook and the macroeconomic scenario of Latvia's CP/NRP are broadly in line with the latest Commission forecast. According to NRP estimates, the implementation of the measures identified in the programme over the period 2013-16 are expected to boost GDP growth by 1.5 pps. per year. The estimates are based on the projected total financing value of NRP measures but details on other underlying assumptions for quantifying the impact are not provided.

2.2. Challenges

The budgetary situation improved considerably in 2012, as the headline deficit decreased to 1.2% of GDP and the structural deficit to 0.3% of GDP. Latvia thus reached its MTO considerably earlier than was envisaged in the 2012 convergence programme. The challenge ahead is to maintain prudent fiscal policy in the growth phase. The Fiscal Discipline Law that was approved by Parliament in January 2013 and entered into force in March 2013 considerably strengthens the legal basis for rules-based fiscal policy and would provide a mechanism to limit expenditure growth in good economic times. However, practical implementation of the law still remains untested.

Latvia has reduced taxes on labour and further steps to lower taxation of labour are planned for 2014-15. However, the focus on low income earners has been insufficient, against high tax wedge for this category. Environmental taxes remain underdeveloped, while the on-going reform of property taxation, which gives more flexibility to local governments, as well as excise taxes, could provide higher budget revenues. Moreover, further reducing the high share of the informal economy and undeclared work could result in additional tax revenue.

Although there have been notable improvements in the labour market, high unemployment remains the most pressing issue. At 28%, youth unemployment is the seventh highest in the EU (2012), and the rate of young people not in employment, education or training is above the EU average. Young people are also overrepresented among emigrants. Long-term unemployment stands at 7.8% of the active population which is significantly above the EU average of 4.6%. The funding and coverage of active labour market policies (ALMPs) is still insufficient, roll-out of new ALMPs is sometimes slow and provision of targeted social services is poor. Low-skilled, pre-pension-age workers, people living in depressed regions and the disabled are experiencing particular difficulties in the labour market. Parents face difficulties to reconcile work and family life due to lack of affordable childcare facilities and flexible workplace practices.

The high proportion of people at risk of poverty or social exclusion (40 %) is a big challenge. Families with children and the unemployed are particularly vulnerable to poverty. There are concerns about the adequacy and coverage social assistance benefits. Child- and family-related benefits are poorly targeted, as a large share goes to the wealthiest part of the population. There are high disparities across local governments in providing social assistance[4], weak incentives to work and insufficient conditionality and activation of the benefit recipients. Unequal access to higher education and poor up-skilling opportunities for the low-skilled also contribute to perpetuating poverty and inequality. The number of low-income pensioners is projected to be high, so medium- and long-term pension adequacy is a significant challenge, also given the projected fall of the replacement rate, further aggravated by freezing of indexation.

In the higher education field, the immediate challenge is implementing Ministry of Education and Science reform proposals, given the preference to maintain status quo in the education sector. This includes implementing quality-based accreditation of study fields, adopting changes to the governance of higher education institutions, promoting internationalisation of higher education and science, and introducing a financing model that rewards quality, combined with increased national higher education financing.

There are concerns that vocational education and training (VET) is failing to provide sufficient quality of skills for the workforce and there is limited availability of quality work-based training, including traineeship/apprenticeship schemes. Evidence from employers indicates skills shortages in areas such as ICT, pharmaceuticals and engineering, and the number of graduates in mathematics, science and technology is insufficient. Participation of adults in lifelong learning is very low and companies are not actively providing training for their workers.

The effectiveness of scientific policy has been undermined by a lack of independent, external evaluation of the relevance of scientific output. Such assessment could support future national and EU funding investments. Latvia's challenge is to rationalise and modernise research activities, keep highly-qualified scientists in the face of international competition, and increase the number of new doctorates awarded. The level of commercialisation of research is low and there is little R&D investment by domestic or foreign companies to support specialisation in innovation-driven sectors.

For the years ahead, key challenges in respect of energy policy will involve continued implementation of the Third Energy Package, including adoption of key legislation particularly in the gas sector. Further key steps needed are the creation of market structures, starting already from April 2014[5], and preparation of the gas sector for the end of its current isolation, including by implementing the planned regional LNG terminal project and other crucial infrastructure, as well as re-negotiation of the regionally-important Incukalns gas storage management contract. In electricity, key steps include finalisation of negotiations with Russia and Belarus on operating the Baltic electricity network and the gradual creation of a Baltic regional electricity market. Renegotiation of the support mechanism for green energy will be another big challenge in the coming months, with substantial implications for the economy's future competitiveness.

Latvia's energy- and carbon intensity is more than double the EU-27 average, with the largest consumers being households and the transport sector. However, speedy and efficient implementation of EU-funded housing insulation projects has been a big challenge, while measures undertaken in the transport sector do not seem to have had a significant effect.

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[4] This document uses the term 'social assistance' in relation to cash or in-kind benefits of last resort targeted to people in need, who do not receive sufficient income from other sources.

[5] In April 2014 the "emerging market" derogation from the 3rd legislative package runs out, including on the provisions of third party access and unbundling of accounts.

Inefficiencies in the civil justice system have a negative impact on the business environment, increasing the risk and cost of doing business. Although positive steps are being taken to remedy the situation, lengthy civil and commercial case proceedings in the first instance and low clearance rates lead to an elevated backlog of court cases. The main challenges include: implementing proposed amendments to civil, administrative and criminal procedural laws; ensuring proper interpretation and implementation of insolvency law; establishing a comprehensive human resources policy for the judiciary linked to professional evaluation of judges; streamlining the system of arbitration courts; and implementing the Law on Mediation.

As regards state-owned enterprises, key challenges for the coming months include: establishing and equipping a professional centralised state-owned enterprise management unit under the Prime Minister, to be operational from January 2014; the gradual transfer of ministries' stakes in enterprises to this unit; minority and non-core-activity share divestments; and bigger privatisation plans for some larger state assets (e.g. telecommunications). These reforms have been well prepared with help from international institutions and are long overdue for implementation.

As regards the financial sector, the experience of the credit boom-bust cycle calls for monitoring of future credit growth and vigilant macro-prudential supervision. The three main challenges ahead include the sale of Citadele Bank, which has been postponed due to allegedly unfavourable market conditions, the sale of remaining 'problematic' bundles of the state-owned Mortgage and Land Bank, and further measures to reduce risks from non-resident banking.

Lastly, institutional capacities of tackling economic, financial, money laundering and tax evasion crimes are challenged by the dynamic developments in the financial sector, including the rapid increase in cross-border financial flows. This concerns the investigation of such crimes, prosecution and the work of judges. In many cases, the knowledge and skills of relevant authorities may need permanent upgrading to successfully prosecute and punish perpetrators.

3. ASSESSMENT OF POLICY AGENDA

3.1. Fiscal policy and taxation

Budgetary developments and debt dynamics

The objective of the budgetary strategy outlined in the programme is to maintain a structural budgetary position which is based on the MTO, with any deviation limited to the incremental impact of systemic pension reform. Latvia reached its MTO, which is a structural deficit of 0.5% of GDP and which is in line with the requirements of the Stability and Growth Pact, in 2012. The pension reform is to be implemented gradually in 2013, 2015 and 2016 and the programme foresees a return to the MTO in 2019. The headline general government position will be maintained at a deficit of around 1% of GDP in 2013-2016, according to the programme.

In 2012 the Council recommended that Latvia ensure progress towards the timely correction of the excessive deficit in 2012, by implementing the budget as was envisaged in the 2012 convergence programme and by ensuring the fiscal effort specified in the Council recommendation under the excessive deficit procedure[6]. The Council also recommended using the better-than-expected cyclical revenue to reduce government debt.

Latvia's general government deficit decreased in 2012 to the level of 1.2% of GDP and the MTO has been achieved in that year. The outcome for 2012 is considerably better than the target of 2.1% of GDP envisaged in the 2012 programme. Moreover, this outcome also includes a one-off deficit-increasing impact of reclassification within the general government of a financial defeasance unit (AS Reverta), amounting to 0.5% of GDP, which was not anticipated in the 2012 programme. This result is better-than-targeted and was achieved despite the fact that, contrary to the Council recommendation, several deficit-increasing measures were adopted in the second half of 2012, lowering the VAT rate by 1 percentage point from July 2012, and the adoption of the supplementary 2012 budget that raised expenditure targets. The good outcome in 2012 does not, however, only reflect a cyclical improvement in taxes caused by more robust growth. Tax efficiency also appears to have improved, reflecting the implementation of dozens of measures in the national action plan to combat the shadow economy, while actual expenditure was somewhat lower than targets set in the amended 2012 budget. Coupled with substantial consolidation measures in the original 2012 budget, this ensured an improvement in the structural balance by 1.3 percentage points of GDP and Latvia thus reached its MTO in 2012, three years earlier than was envisaged in the 2012 programme.

Box 1. Excessive deficit procedure for Latvia

On 7 July 2009, based on a recommendation by the Commission, the Council decided in accordance with Article 104(6) TEC that an excessive deficit existed in Latvia and addressed recommendations to Latvia in accordance with Article 104(7) TEC with a view to bringing an end to the situation of an excessive government deficit. The Council recommended that Latvia puts an end to the excessive deficit situation as rapidly as possible and at the latest by 2012, by ensuring an average annual fiscal effort of at least 2¾% of GDP over the period 2010-2012. Moreover, Latvia was recommended to strengthen fiscal governance and transparency, by improving the budgetary framework and reinforcing spending controls, and financial market regulation and supervision.

An overview of the current state of excessive deficit procedures, including additional steps adopted after the finalisation of this Staff Working Document, is available on: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/index_en.htm (please refer to country sections at the bottom of the page).

The headline deficit is projected to remain broadly unchanged in 2013. The programme projects a headline general government deficit of 1.1% of GDP in 2013, which is very close to the deficit of 1.2% of GDP expected in the Commission's 2013 spring forecast; both projections are better than the target of -1.4% in the 2012 convergence programme, which was also the basis for the 2013 state budget as adopted by the Latvian Parliament on 15 November 2012. The most significant policy changes in 2013 are the increase in state contributions to the privately funded pension scheme (see Box 2 and the section on long-term sustainability of public finances) and the first step of the three-year strategy to lower the personal income tax rate from 25% to 20% (described in more detail in the section on tax systems).

However, there are risks that deviation from the MTO may be significantly larger than the incremental impact of the systemic pension reform. Taking into account policy

[6] See documents related to the excessive deficit procedure for Latvia under http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/latvia_en.htm

changes described in the Box 2 and other factors, the structural balance[7] is expected to worsen in 2013 by 1.2 pps. according to the programme scenario and by 1.0 pp. according to the Commission's 2013 spring forecast. The growth rate of government expenditure, net of discretionary revenue measures, will exceed the reference medium-term rate of potential GDP growth of 1.18%, according to both the programme scenario and the Commission forecast. When the impact of the systemic pension reform is taken into account, the risk of deviation both in terms of the deviation of the structural balance from the MTO and in terms of expenditure growth being higher than the medium-term potential GDP becomes less pronounced, but nevertheless some indicators point to a risk of significant deviation even after the impact of the systemic pension reform is taken into account.

Box 2. Main budgetary measures

Revenue	Expenditure
2013	
• Increase in state contributions to the private pension scheme from 2% to 4% of gross wages (-0.5% of GDP) • Reduction in standard VAT rate from 22% to 21% from July 2012 (-0.2% of GDP) • Reduction in the personal income tax rate from 25% to 24% (-0.2% of GDP) • Measures to counter the shadow economy (+0.1% of GDP)	• Suspension of pension indexation (impact not specified)
2014	
• Reduction in the personal income tax rate from 24% to 22% (-0.4% of GDP) • Measures to counter the shadow economy (+0.1% of GDP)	• Gradual increase in retirement age by 3 months annually (-0.1% of GDP)
2015	
• Increase in state contributions to the private pension scheme from 4% to 5% of gross wage (-0.27% of GDP) • Reduction in the personal income tax rate from 22% to 20% (-0.4% of GDP) • Measures to counter the shadow economy (+0.1% of GDP)	• Gradual increase in retirement age by 3 months annually (-0.1% of GDP)
2016	
• Increase in state contributions to the private pension scheme from 5% to 6% of gross wage (-0.28% of GDP) • Change in the order of the vehicle tax payment (-0.1% of GDP) • Measures to counter the shadow economy (+0.1% of GDP)	• Gradual increase in retirement age by 3 months annually (-0.1% of GDP)

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

[7] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided in the programme, using the commonly agreed methodology. It should be noted that given the volatility of economic developments in Latvia in recent years, as well as on-going changes in the structure of the economy, the calculation of the potential growth is subject to rather high uncertainty. In particular, the recalculated information of the programme results in considerably higher estimate of the output gap (1.3% in 2013 and 2.7% in 2014) than the original programme information (respectively 0.2% and 0.4%) and the Commission's 2013 spring forecast (respectively 0.6% and 1.7%).

In 2014, both the programme scenario and the Commission's 2013 spring forecast expect a headline deficit of 0.9% of GDP under current policies. The most notable policy change is the decrease in the personal income tax rate from 24% to 22%, which is partly offset by the impact of measures against the informal economy and the start of the pension reform, according to which the statutory pension age will be increased by 3 months annually between 2014 and 2025. As a result, the structural balance is expected to worsen by 0.2 pp. in the programme scenario and by 0.1 pp. in the Commission forecast. Also in 2014 there is a risk that the growth rate of government expenditure, net of discretionary revenue measures, will exceed the reference medium-term rate of potential GDP growth of -0.05%, according to both the programme scenario and the Commission forecast.

Risks to the nominal outlook for public finances are broadly balanced in 2013 and 2014. Apart from possible deviations from the macroeconomic scenario, the positive risks relate to the possibility that tax revenue could be better, if the improvement in tax efficiency continues at the same rate as in 2012, and/or if actual expenditure will be somewhat lower than planned, as it was the case in 2012. On the other hand, there are implementation risks (including those related to local elections in 2013 and general elections in 2014), and/or the possibility that some of the fiscal risks might materialise. In particular, the government could face a guarantee call in relation to an industrial company in difficulties, amounting up to 0.3 pp. of GDP if the guarantee is called in full, and possibly other costs related to this company in 2013 or 2014.

In 2015 and 2016 the headline deficit is affected by the systemic pension reform and by planned tax cuts, resulting in some further deterioration of the structural balance. In the programme's later years, the fiscal outlook is mainly influenced by the continuing systemic pension reform in 2015 and 2016 (with an impact of around 0.3 pp. of GDP in each year) and by the lowering of the personal income tax rate to 20% in 2015. This is partly offset by increasing the statutory pension age and other plans that aim to improve the efficiency of public expenditure. As a result, the structural balance is set to continue to worsen by 0.2-0.3 pp. annually and the growth rate of government expenditure, net of discretionary revenue measures, is set to exceed the reference medium-term rate of potential GDP growth of -0.05%, even after excluding the incremental impact of the systemic pension reform.

The debt-to-GDP ratio will remain well below the level of 60% of GDP. In the programme scenario, general government debt is projected to increase from 40.7% of GDP in 2012 to 44.5% in 2013, and then fall rapidly to 34.6% of GDP in 2016. This reflects the accumulation of financial assets in anticipation of large repayments of loans under the 2009-11 financial assistance programme (as evidenced by the high stock-flow adjustment in 2013) and the subsequent repayment of a large share of these loans in 2014-15. Latvia currently enjoys very favourable market conditions. In late 2012, the authorities made an early repayment of their outstanding obligations towards the IMF under the financial assistance programme, replacing this part of official debt by market financing. Since the debt-to-GDP ratio is below the reference value, the debt reduction benchmark is not applicable. Medium-term debt projections (see Graph below Table V in annex) also indicate that full implementation of the programme would lead to a smaller debt-to-GDP ratio in 2020.

Long-term sustainability

The long-term sustainability of public finances appears secured. Latvian public finances do not appear to face sustainability challenges either in the short-term, medium-term or long-term perspectives. This conclusion reflects in particular a projected decrease in age-related spending in the period 2010 to 2060, which contrasts with an average increase in the EU, and a relatively low level of government debt (40.7% of GDP in 2012, expected to decrease to 40.1% in 2014 according to the Commission's forecast). However, these projections imply a steep decline in the replacement ratio of the notional defined contribution public pension system, representing a risk to the adequacy of future pensions or a risk of current policies being reviewed, which could have an impact on future sustainability.

The systemic pension reform will continue in 2013-2016. Latvia increased state contributions to the statutory funded pension scheme from 2% of gross wages to 4% in 2013, while the overall social contribution rate remained unchanged; there will be a further increase to 5% in 2015 and 6% in 2016. While this increase is more gradual than was recommended by the Council in 2012, it is not likely to have a substantial negative impact on the sustainability or adequacy of pensions, in particular when coupled with the recently legislated increase in statutory pension age from 62 to 65 years between 2014 and 2025.

According to the 2012 Ageing Report[8], projections for the health and long-term care are rather favourable. At the same time, health status indicators are relatively weak, in comparison with those of other Member States. This could mean a greater need for health and long-term care in the future, and therefore a possibility of higher costs.

Fiscal framework

The recent adoption of the Fiscal Discipline Law strengthens the fiscal framework. Until recently, the fiscal framework in Latvia lacked mechanisms to limit expenditure growth in good economic times. Implementing a comprehensive set of rules to govern fiscal policy throughout the cycle had therefore been a priority and was reflected in the 2012 Council Recommendations. The relevant draft law was adopted by the government in late 2011 and was fleshed out in the course of parliamentary scrutiny, notably to reflect the entry into force of the 'six-pack' (legislation to strengthen economic governance) and the decision by Latvia to join the Treaty on Stability, Coordination and Governance. The resulting Fiscal Discipline Law was approved by the Latvian Parliament on 31 January 2013 and entered into force on 6 March 2013.

This law establishes the principle of budgetary targeting throughout the cycle, with the benchmark structural deficit of 0.5% of GDP, but the law still remains untested. Practical implementation takes place through a multi-annual budget framework law (adopted as a rule annually in spring, with the exception of 2013 and 2014 when transitional provisions apply) and annual budget laws. It provides mechanisms for adjustment of the budgetary trajectory in the event of any deviation from the medium-term objective, as well as mechanisms to ensure that the expenditure growth rule is adhered to. To this end, the expenditure ceilings in the multi-annual budget framework law and in annual budget laws are determined in such a way that both the balance rule and the expenditure growth rule stemming from the reinforced Stability and Growth Pact are satisfied. The Fiscal Discipline Law also contains provisions regarding the establishment of an independent Fiscal Council, to be operational from 1 January 2014, which will oversee compliance with the set of fiscal rules, including by publishing regular and ad hoc reports. Given the very recent nature of the law, next budgets, in particular the budget for 2014, will provide real-life test for the new framework.

[8] See http://ec.europa.eu/economy_finance/publications/european_economy/2012/2012-ageing-report_en.htm.

Tax system

Latvia has one of the lowest tax-to-GDP ratios in the EU, at 27.9% of GDP in 2012, with relatively high reliance on consumption taxes and low reliance on taxation of capital. While the implicit tax rate on labour is below the EU average, the single personal income tax (PIT) rate translates into particularly high labour taxation for low-income earners: the tax wedge for single earners was the sixth highest in the EU in 2010 for people earning 67% of average wage. In contrast, the tax wedge for high-income earners is well below the EU average. In line with these labour tax incentives, the low-skilled employment rate of 46.7% is well below the EU average and almost 40 percentage points lower than that of high skilled-workers, which, at 83.4%, is in line with the EU average.

Latvia has taken measures to reduce labour taxation, but the focus on low income earners has been insufficient. The three-year strategy to lower the PIT rate from 25% to 20% was adopted in mid-2012 and the first step (lowering the PIT rate to 24%) came into effect in January 2013. In addition, targeted relief for families with children (an increased monthly non-taxable threshold for dependants from LVL 70 (€ 100) to LVL 80 (€ 114)) will come into force in July 2013. While these government decisions are in line with the objectives of the 2012 Council recommendations to shift taxation away from labour, no compensatory tax measures were announced (although the on-going reform of property taxation, which gives the local governments more flexibility, could result in a higher share of property taxation). These decisions did not specifically address the situation of low-income earners either. Moreover, as the elasticity of demand and supply with respect to wages is higher for lower-income groups, focusing reduction of labour taxes on low-income earners would have a more pronounced impact on reducing unemployment. The concerns about high in-work poverty and large numbers of low-wage earners provide additional arguments in favour of concentrating the tax reduction efforts on lower-income groups.

The labour tax cuts were not accompanied by an increase in consumption taxes. To the contrary, the VAT rate was lowered from 22% to 21% as from July 2012, partly reversing the measures taken during the crisis, when the standard VAT rate was increased from 18% to 22% and the reduced rate from 5% to 12%, while narrowing the scope of its application. However, these crisis-related rate increases were not reflected in VAT revenues or in the implicit tax rate on consumption. Instead, the VAT revenue ratio, which compares actual VAT revenue to theoretical VAT revenue at standard rates, decreased from around 65% before the crisis to 43.2% in 2011 — the fourth lowest in the EU. Given the comparatively limited application of reduced rates, this indicates that the efficiency of the VAT system has been greatly affected by the economic crisis[9] and has potential for further improvement as the economy recovers, in particular if supported by policy action to improve tax collection.

The proportion of property taxes in overall taxation has increased in recent years. The on-going reform of property taxation since January 2013, which gives local governments flexibility in choosing appropriate tax rates, could further improve the revenue base of local governments in the medium term, thus providing opportunities for a tax shift. Given the very recent nature of the reform, its results would need to be assessed at a later stage. A review of cadastral values to better reflect the value of individual properties and real estate market developments would provide another way of further increasing reliance on property taxation.

[9] These inefficiencies might be the result of high levels of cross-border shopping, tax evasion or avoidance or even a shift towards consumption goods, which are taxed at the reduced rate.

There is scope for further broadening of tax base for environmental taxes. The proportion of environment taxes is at the EU average, albeit dominated by fuel taxation. Furthermore, the implicit tax rate on energy – measuring energy taxation per unit of energy – is the lowest in the EU, reflecting low energy efficiency against relatively low tax rates for energy sources. The weak indicators relating to waste management and air quality[10] suggest that the taxation rates in place may not be conducive to environmentally friendly behaviour. Further broadening of the tax base for environmental taxes, including pollution and energy sources, as well as a progressive increase of the existing landfill tax, would help achieve environmental goals, while allowing taxation to be shifted away from low-income earners.

The government has stepped up efforts to combat the informal economy. Although backward-looking indicators still point to considerable challenges in this area, the impact of recent policy measures is gradually translating into improved tax collection rates, particularly visible in 2012, when the annual increase in total tax revenue as reported by Eurostat was above GDP growth. The State Revenue Service has been considerably reinforced during the past few years and its organisational structure has been adapted to strengthen the audit function. In parallel, several policy decisions have been or are being adopted in order to reduce the stock of tax arrears and to limit their accumulation in the future. In parallel, the allowed frequency of tax-free movement of goods on the EU external border has been reduced as from 2012, and several legislative measures have been taken in order to limit opportunities for fraudulent behaviour or to strengthen applicable sanctions. At the same time, Latvia does not systematically make use of third-party information to review individual income declarations. According to the World Bank Ease of Paying Taxes Report 2013[11], the costs of tax compliance in Latvia are relatively high despite recent improvements and should therefore remain in the focus of attention.

3.2. Financial sector

The banking sector, with total assets of around 130% of GDP, is relatively moderate compared to 370% of GDP in the EU as a whole. Around half of deposits are non-resident, in particular from Russia and other CIS countries. After the collapse of the second biggest domestic bank, Parex, in 2008, which necessitated a request for a Balance of Payments (BoP) assistance programme from the EU and the IMF, the authorities have taken appropriate supervisory and resolution measures. As part of the programme, a blocked financial sector account at the Central Bank was established with around EUR 650 million that were gradually released as the authorities implemented the restructuring and sale of two state-owned banks and other financial-sector reforms.

Further actions have been taken to strengthen the financial system over the past months. This includes: closer supervision of the banks owned by non-EU entities and having high exposure to non-EU customers; continued progress on the orderly resolution of ex-Parex Bank[12]; selling of the Mortgage and Land Bank's commercial assets (excluding the real estate bad loan bundle); measures to deal with issues that emerged in the context of the Krajbanka

[10] In particular, 88% of municipal waste was landfilled and only 10% recycled in Latvia in 2011, against 37% and 25% respectively for the EU as a whole. Air pollution levels exceeded legislated limits in some urban areas in 2011.

[11] http://www.doingbusiness.org/~/media/GIAWB/Doing%20Business/Documents/Special-Reports/Paying-Taxes-2013.pdf

[12] Former Parex Bank was split into a Resolution Bank (Parex bank) and a New Bank (Citadele bank), which is continuing business activity. In 2012 Parex bank changed its status to a distressed asset management company under the new name of Reverta.

fall-out (e.g. thorough checks of availability of correspondent account financing); and activities to improve the public's financial knowledge.

The Mortgage and Land Bank sale process has taken a long time. Accepting financially reasonable offers received for the more problematic commercial assets, rather than keeping them under state management, seems the best way forward. It is also important to assess how the Mortgage and Land Bank could be managed more effectively as a development bank. Preferably, an open competition should be organised to attract managers with extensive experience in development bank activities.

There has been little progress as regards the setting-up of a Single Development Institution, including deciding on further operations of the Mortgage and Land Bank's development part. The institution is to implement state aid programmes through financial instruments currently handled by the Mortgage and Land Bank, the Latvian Guarantee Agency, and the Rural Development Fund. A swift decision on the Institution is particularly important in view of the new EU financing period, where emphasis on financial engineering instruments may be significant.

As regards access to finance, new lending to residents has improved, but remains weak as gradual deleveraging continues in the household and corporate sectors. However, well-established and export-oriented companies seem to have little trouble accessing credit. Effective and timely implementation of a wide range of Structural Fund-supported financial engineering programmes could further promote access to financing. While the post-crisis structural adjustment has been overall successful, the experience of a pronounced boom-bust cycle calls for vigilant monitoring of future credit growth and macro-financial stability.

The authorities have not devoted adequate attention and resources to tackling complex economic and financial crimes. Some of the institutions under the Prosecutor General Office and the Ministries of Finance and Interior need more staff, training, and resources to perform their tasks effectively. Furthermore, the significant non-resident deposit business in Latvia poses some specific challenges. Continuous high inflow of foreign capital could fuel excessive lending or stimulate foreign investment by domestic banks without providing them with a sufficiently stable funding base. The authorities should step-up efforts to contain the risks stemming from the non-resident banking sector. Finally, another emerging challenge with significant social implications is containing and enhancing the monitoring of non-bank lending activities.

3.3. Labour market, education and social policies

Unemployment in Latvia remains above the EU average. High youth unemployment and long-term unemployment are reasons of particular concern. Activation of the unemployed and benefit recipients is low, while the tax wedge for low-wage earners is among the highest in the EU, which is hindering job creation for the low-skilled. Challenges for the higher education field include a need for better compliance with labour market needs and raising the economy's innovation potential. There are concerns about vocational education and training failing to provide sufficient quality of skills for the workforce and about limited availability of quality work-based training. The high proportion of the population at risk of poverty or social exclusion, high income inequality and increasing material deprivation are also significant challenges. Children are particularly exposed to the risks of poverty.

Labour market

Latvia has taken a number of steps to tackle long-term and youth unemployment. The level of long-term and youth unemployment, however, stays high at 7.8% and 28.4% respectively in 2012, though starting to decrease since its peak in 2010. Funding and coverage of ALMPs was increased in 2013 as compared to 2012, and more unemployed people will be involved in training, wage subsidies and public works programmes. Profiling of the unemployed, which is significantly delayed, and improved job search assistance, is to be implemented in 2013 to channel resources to those who need them most. Encouragingly, the authorities are re-assessing and improving the effectiveness and quality of training provided to the unemployed, implementing in-company training programmes (though the ESF-financed 'training with employers' programme has faced delays), and a small-scale Minnesota programme providing support to unemployed people with addiction problems, and introducing mobility grants to help the long-term unemployed to move away from areas of joblessness.

Young people are being involved in vocational training programmes, but there are still challenges. In addition to measures described above, 2 000 young people without professional qualifications will be involved in a short cycle (1-1.5 years) vocational training programme and a new 'Workshops for Young People' measure has been prepared to give young people the opportunity to try out three different professions in vocational schools. Latvia has a range of existing and new measures targeting young people, but has not yet established a comprehensive system delivering a Youth Guarantee[13]. Similarly, there are no measures to support people at pre-retirement age, who are often subject to discriminatory attitudes and sometimes lack sufficient skills. The ESF will be an important source of funding for youth employment policies, in particular through the support of the Youth Employment Initiative, which will deliver measures targeted at young people not in employment, education or training.

Lack of rigorous evaluation of ALMP measures was identified as a problem in earlier assessments. Latvia has addressed this issue by concluding an advisory agreement with the World Bank, which includes evaluation of the ALMPs and recommendations on improving their effectiveness. Preliminary results are expected by summer 2013 and may serve as a basis for 2014 budget proposals as regards social assistance, benefits and ALMPs.

The overall response from Latvian authorities is adequate and relevant, even though, due to the extent of the challenges faced, efforts are not sufficient and several measures are in the early stages of implementation. The long-term unemployed often face barriers to labour market entry which are not addressed by traditional ALMPs such as caring responsibilities, health problems or disability, addictions, lack of motivation, low level of life skills and others. To overcome these barriers, providing targeted social services is equally important. Many of the long-term unemployed are involved in the European Social Fund-financed public works programme, which is used as a substitute for social assistance and does not adequately address the main barriers to employment.

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

Education

The Ministry of Education and Science has proposed ambitious reforms that would largely address the challenges faced by higher education. The reform of the accreditation process includes moving from accreditation of study programmes to study fields and increasing the independence and impartiality of the accreditation committee (for accreditation purposes, as of 2014 higher education institutions will be allowed to select any of the independent institutions included in the European Quality Assurance Register). Large-scale evaluation of higher education programmes was completed with European Social Fund financing and the results will be used as input for budgetary and accreditation processes. Reform plans also include: separating academic and management functions of the universities; developing a new financing model; attracting international teaching staff and students; and further consolidating higher education institutions.

The response to the CSR is adequate and relevant, even if these plans are at an early stage. If properly implemented, they will have a significant positive impact on the quality of higher education in Latvia.

Latvia has allocated significant ERDF funds for renovating 11 VET schools. However, close monitoring will be needed to ensure timely and effective absorption of the allocated financing in the next few years. A project to improve the attractiveness of VET curricula and raise professional standards is ongoing, in cooperation with employer-led Sectoral Expert Councils. Latvia is drawing up plans to improve VET governance and introduce more flexible modes of learning, including provision of education for adults and the unemployed. While participation in VET started from very low levels and has been increasing, this may be more due to monetary incentives (eg. stipends to VET students) than to real attractiveness of programmes. Latvia still lacks a comprehensive nationwide system of impartial career guidance to help students make informed choices. Importantly, there has not been any rigorous evaluation of the traineeship/apprenticeship schemes, though concerns have been raised as regards their quality, availability, attractiveness to employers and organisational aspects.

Both the labour market situation and the policies implemented during recent years have contributed to the reduction in the rate of early school leavers (10.5%, against the EU average of 12.8% in 2012). To bring more young people back into education, an additional 2 000 young unemployed will be involved in short cycle (1-1.5 years) VET programmes to obtain professional qualifications. Proper implementation of the on-going measures will be key to further reducing dropout numbers. As early school leavers are disproportionally affected by unemployment, further reducing their number will also have a positive impact on youth unemployment.

Social policies and poverty

Lack of fiscal space has led Latvia to take some decisions that are likely to aggravate extreme poverty and exacerbate the existing inequality in access to social assistance across local governments. As of January 2013, the level of guaranteed minimum income (GMI) was decreased and state budget financing of the GMI benefit was abolished. These decisions were seemingly taken without analysis of the impact on incentives to work and poverty, and prior to the results of two studies on social assistance.

There has been no significant direct action to address problems related to social assistance identified in the Commission's 2012 assessment: transparency, benefit adequacy and coverage, and insufficient activation measures for benefit recipients. There is also no unified social assistance data management system providing individual-level data to enable better monitoring of social assistance policies. The targeting of child-related benefits remains unfavourable to low-income households. The at-risk-of-poverty rate increased slightly in 2012, suggesting that growth does not automatically translate into reduced poverty and that targeted policies are necessary.

Some improvements are nevertheless taking place. More positively, Latvia has partially addressed the problem of low coverage of unemployment benefits by increasing their duration to nine months for all unemployed people as of January 2013 and, with a view to improving the demographic situation, the sliding scale cap on maternity/paternity/parental allowances was increased; however these measures will benefit only middle- and high-income families. Families and municipalities were allocated additional support for providing kindergarten services and financing was granted for in-vitro fertilisation procedures. In order to support poorer families, minimum monthly parental benefits, child-care benefits and child-care benefit supplements for children born in multiple births were increased to EUR 140, including for parents without social insurance, and the PIT allowance for dependents was increased to EUR 115. Given the high child poverty rates, it is important to monitor the effects of these decisions on child poverty and child-related benefits.

An evaluation of the social assistance system is on-going to provide the support for evidence-based policy-making to reform the social assistance system. The authorities have also started work on the Guidelines for Development of Social Services with the aim of improving social services. It is expected that high social inequality will already be addressed in the 2014 budget.

3.4. Structural measures promoting growth and competitiveness

Latvia's indicators of competitiveness have improved substantially since the start of internal adjustment triggered by the financial crisis in 2008-09. This is also evident from the recent substantial gains in export market shares and the rising proportion of exports in GDP. Nevertheless, exports remain to a large extent dependent on low value-added industries with low technological intake. This indicates certain challenges as regards competitiveness in higher value-added sectors. The areas and reforms listed below are paramount to further improving Latvia's competitiveness.

The Structural Funds and Cohesion Fund, which financed most of Latvia's public investment in recent years, have played an important role in supporting structural reforms and alleviating the effects of the crisis.

Electricity market

In 2012, Latvia made progress in opening its electricity market to competition for industrial users and participation in the regional market. The proportion of regulated prices has decreased considerably, standing at 25% in November 2012. Latvia is to join Nord Pool Spot trading in June 2013. The phasing-out of regulated prices for household and small non-household consumers is still outstanding and would stimulate competition in the electricity sector. In this regard, the phasing-out of price regulation for electricity may require identification of vulnerable customers and design of appropriate protection mechanisms, as well as empowering consumers to make informed choices.

The electricity supply system is robust. There are no internal bottlenecks between Latvia and Lithuania; however Estonian and Latvian cross-border transmission infrastructure is frequently congested. Electricity generation is based on hydro-energy, which has led to notable fluctuations over the last decade, and high dependence on imports, particularly from Russia, when water levels are low. Gas, which is 100% imported, is also used extensively for electricity generation. For historical reasons, the Latvian electricity system is heavily interconnected with the networks of Belarus, Russia, Estonia and Lithuania (BRELL ring agreement). There are on-going negotiations with Russia and Belarus on the technical operation of the networks to allow for proper implementation of EU energy legislation. In the medium term, Latvia and the other Baltic States aim at synchronisation with the EU electricity system, which requires significant investment. The Latvian network needs to be reinforced to be able to transport significant amounts of energy via the Baltic transmission system from/to Finland, Sweden or Poland.

Gas market

There has been no progress in opening the natural gas sector and a single-source dependency prevails. The authorities are facing difficult negotiations with Gazprom/Latvijas Gaze as regards preparation of the gas sector for ending isolation and creating respective market structures, starting from April 2014. There have recently been calls by some politicians in the media to delay this reform and make it subject to ending of Latvia's overall derogation from implementing other crucial elements of the Third Energy Package, such as unbundling. This would not be in line with Latvia's earlier position and endangers subsequent market opening. This includes renegotiation of the regionally important Incukalns gas storage management contract, which could contribute to the development of a more competitive gas market and yield substantially bigger revenues for the state than so far.

To increase security of supply and enable proper functioning of the energy market, new supply routes have to be developed in the Baltic region. This includes the Latvian-Lithuanian reverse-flow project linked to the Poland-Lithuania gas interconnection, the BalticConnector between Estonia and Finland, and the regional LNG terminal. Latvia has confirmed its willingness to proceed in line with the findings of the Commission-financed LNG study.

No decision has been taken on roll-out of smart meters for electricity or gas. The country has only reported that the cost-benefit analysis results for both electricity and gas were negative.

Energy efficiency

Latvia's energy and carbon intensity is more than double the EU-27 average[14]. Latvia has put forward a balanced mix of policy measures addressing energy savings for the main sectors of the economy. It is foreseen that in coming years more than 70% of these energy savings will be generated in the buildings sector, including modernisation of district heating networks, where the potential is significant. The European Regional Development Fund, Cohesion Fund and the Climate Change Facility Instrument play an important role in financing already implemented and planned energy-efficiency measures. Some progress has been achieved in the insulation of administrative and residential buildings and results show significant energy savings of above 30% for the pilot residential projects. However, the number of insulated residential buildings remains very small relative to the stock of buildings with large energy losses. The implementation of housing insulation projects has been slow and hundreds of

[14] Latvia's energy consumption stood at 327 kgoe/k€ during the 2005-10 period, more than twice the EU-27 average of 153 goe/€. Similarly, with a 0.8t CO_2 equivalent/1000 €, the Latvian economy's carbon intensity is two times higher than the EU average.

projects are currently in the pipeline. It is important that the authorities closely monitor the quality of construction works and materials used to achieve the projected energy savings. The adoption of the building energy-effectiveness law in 2012 is a commendable step.

Measures focusing on higher uptake of energy performance contracting (legal and financial), ensuring mandatory measuring of individual consumption in renovated buildings, and specialised training of the building workforce, would further support this process. The complete and timely transposition and effective implementation of the Energy Efficiency Directive (by June 2014) and the financing possibilities under the European Structural and Investment Funds would additionally promote energy efficiency.

Research and innovation

The Commission's 2011 Innovation Union Scoreboard identifies Latvia as a modest innovator whose aggregate Innovation Index score (0.201) is still significantly below the EU average (0.516). Similarly, the 2012-13 Global Competitiveness Report of the World Economic Forum, which ranks Latvia 55th out of 144 countries, finds that Latvia's performance on business sophistication and innovation could be greatly improved. This chimes with the Latvian Competitiveness Report 2011, prepared by independent academics, which points to limited innovation activity, partly due to a lack of highly-qualified scientists and engineers. Scientific performance, measured as the proportion of publications in the top 10% most-cited journals, is low.

Regarding the Europe 2020 target for R&D intensity, Latvia's objective is to devote 1.5% of GDP to R&D by 2020. However, its current R&D intensity of only 0.7% of GDP is well below this target. While public investment has recently increased, this is mainly due to several major programmes funded by the Structural Funds. There is little research and innovation investment by either domestic companies or foreign affiliates to support specialisation in knowledge-intensive and innovation-driven sectors. Latvia has the lowest business R&D intensity in the EU (0.19% of GDP in 2011), and licence and patent revenue is rather low.

An evaluation of scientific institutions is expected in 2013. Regarding the rationalisation of scientific institutions, an evaluation of the effectiveness of scientific institutions and their development strategies and consolidation will be carried out in 2013, following agreement with the Nordic Council of Ministers. This important assessment should support future budget and European Structural and Investment Funds allocations, and improve the quality of scientific output.

There is a very high proportion of Structural Funds in public R&D funding, thus shifting the balance towards project-based, competitive funding. Increased national financing for scientific institutions' base expenditure (infrastructure maintenance, personnel expenses, co-financing for international financial instruments and studies) would support stability and further development of the science and innovation sector. A major issue concerns funding of the R&D sector after 2013, before the new round of Structural Funds becomes operational. Moreover, as the overall level of public support will remain limited, introducing broader tax incentives for research and innovation may need to be considered, including extending existing corporate tax rate allowances for investment in research and innovation.

Several initiatives to stimulate innovation are in the pipeline. As regards incentives for companies to innovate, a voucher programme for small- and medium-sized enterprises will be launched in 2013 to support entrepreneurs in the purchase of external services, such as industrial research. Also, 11 cluster projects and 6 Competence Centres are operational, and aim to promote cooperation between companies and research and education institutions in the development of new products. Also, several Structural Fund-supported programmes are being implemented to promote development of higher-value added products and to introduce new technologies. It is still too early to assess the impact of these initiatives on commercial innovation.

Transport

There is room to optimise transport systems. Developing integrated, intermodal, low-carbon and intelligent public and urban transport systems, adapting public road transport to renewable energy sources, and further electrification of railway lines would make it easier to achieve the Europe 2020 targets. Latvia plays an important role in connecting the three Baltic States with the rest of the EU. The modal split in the transport sector is characterised by a large proportion of rail transport, although the level of electrification is low. Overall connectivity might be improved by realising the European-gauge railway infrastructure project Rail Baltic which would connect the main EU networks with north-eastern Europe as part of the TEN-T policy and is planned to be taken forward during the next financial perspectives of 2014-2020. The project should be completed by 2023.

Major concerns relate to the poor quality of road infrastructure, mainly due to underfinancing of transport infrastructure in the last 20 years. EU financing is gradually improving the situation, but not enough to radically improve the road network quality. Thus, to achieve significant improvement in the medium to long term, the authorities may need to greatly increase national financing, implement public-private partnership projects (based on best international experience), or introduce toll roads. In this context, Latvia is one of the few Member States not to have any type of road charging for heavy goods vehicles. However, the Eurovignette legislation is expected to come into force in 2014.

Latvian ports in particular could be a source of efficiency gains. As regards governance and operational standards of Latvian ports, the World Bank has been invited to conduct a comprehensive study on competitiveness, governance and investment return of the biggest ports. The observed quality of governance in the biggest Latvian ports and the government's tools to achieve efficiency-improving changes seem inadequate.

Competition

The Commission has repeatedly emphasised the importance of active surveillance of companies' compliance with competition rules (cartels, abuse of dominant position, mergers), as this may contribute to ensuring long-term price level sustainability. The authorities have proposed amendments to the Competition Law, including prioritising initiation of cases on markets with essential impact on competition, improving fine collection, and granting wider powers to obtain information necessary in case of investigation. However, it will take time to implement these measures. On a broader level, the authorities have initiated discussions on strengthening the functional, institutional and financial independence of the Competition Council. Despite additional financing having been granted in the 2012 budget, the Competition Council's resources remain limited.

Public procurement

Comprehensive changes to the Public Procurement Law have been adopted, including an obligation for local governments to further centralise procurements and extend the use of the Electronic Procurement System. The number of disputed procurements is falling, possibly as a result of more intensive ex ante procurement documentation checks by the

Procurement Monitoring Office and other contracting agencies, and more training for officials dealing with procurements.

As regards administrative responsibility for irregularities in procurement tenders, key law amendments will likely be adopted by the parliament in 2013. This entails administrative penalties for individual contracting officials: a warning, a fine of up to EUR 700, or disqualification from the public procurement evaluation committee. This is expected to improve the quality of work of procurement evaluation committees and increase use of the Electronic Procurement System.

There are concerns about the growing number of local government 'in-house' procurements, which are exempt from normal public procurement regulations (as the service provider belongs to the municipality). In the past few years there has been a trend to increase administrative intervention of municipalities and other public bodies in commercial activities in waste management, provision of house maintenance services and port services.

Renewable energy, greenhouse gas emissions and waste management

Latvia is committed to reaching its goal of renewable energy sources (RES) representing 40% of its final energy consumption, and 10% in the transport sector, by 2020. In 2011, the energy-consumption mix had the second highest RES proportion in the EU-27 (after Sweden), reaching 33.1%. Latvia is unlikely to reach the first interim target of 34.1% under the EU Renewable Energy Directive. In 2011, the proportion of renewable energy in the transport sector increased to 4.8 %, which is above the 2011 national target of 4.1% set out in the Latvian Renewable Energy Action Plan. As of 2011, Latvia's support scheme for renewable energy is on hold and the government expressed the intention to revise it to develop a stable, coherent, predictable and cost-effective RES support framework, whilst avoiding changes that affect the legitimate expectations of investors.

Latvia is permitted to increase emissions not covered by the EU Emissions Trading Scheme (ETS) by 17% in 2020 compared to 2005. The latest projections[15] suggest that Latvia is on track with an emissions increase of 4% in 2011 compared to 2005. Greenhouse gas emissions from the transport sector accounted for 26.7% of total emissions in 2010[16]. Though there are a number of measures in place to decarbonise the transport sector, i.e. raising taxes on fuels, granting exemptions for biofuels, and a newly introduced registration tax based on differentiated CO_2 emissions, further work is required to address high transport sector emissions and low fuel efficiency. New cars had the second highest CO_2 emissions per km in the EU in 2011 (low fuel efficiency). Developing integrated, intermodal, low-carbon and intelligent public and urban transport systems, adapting public road transport to renewable energy sources, as well as further electrification of railway lines, would make it easier to achieve the Europe 2020 targets.

In 2011 Latvia still landfilled 88% of municipal waste, with only 10% being recycled and 1% composted. In line with EU waste legislation, landfilling of biodegradable waste should be reduced to 35% and 50% of municipal waste should be recycled, including composted, by 2020. The total typical charge for landfilling is EUR 40 per tonne of non-hazardous municipal waste, but it is still low compared to the EU average of about EUR 80 per tonne. A progressive increase of the existing landfill tax would facilitate the diversion of

[15] European Environmental Agency: Greenhouse gas emission trends and projections in Europe 2012 Tracking progress towards Kyoto and 2020 targets, table 9.2., page 88.
[16] Ibid, page 126.

waste from landfill, while revenues could support separate collection and alternative infrastructure. Also, the introduction of an incineration tax would make recycling economically more viable. Significant environmental challenges remain in the water management sector, with wastewater not being collected in many agglomerations.

Business environment

Latvia has implemented a series of ambitious reforms in recent years, including reduced company start-up costs and micro company regime, simplified procedures for property registration, construction permits and tax collection, and improved insolvency procedures. In the World Bank 2013 report on ease of doing business, which covers performance in 2012, Latvia ranks 25th. Still, among other issues, Latvia has so far failed to adopt a revised Construction Law and the Construction Information System is yet to be implemented, long court cases are preventing companies from effective settlement of commercial disputes, getting an electricity connection takes time, and many local governments lack capacities and incentives to attract investment and jobs.

ICT

Latvia ranks among the worst-performing Member States when it comes to fixed broadband coverage. In particular, it is one of the five worst-performing Member States in rural broadband coverage: it had 67% rural fixed coverage compared to 78% in the EU-27. Its take-up of broadband is also below EU average, with a fixed broadband penetration rate of 22.5%, against the EU average of 28%. There are concerns that the supply of ICT specialists cannot meet growing demand and companies' needs. A national broadband strategy was adopted in December 2012; however it is too early to assess its impact.

3.5. Modernisation of public administration

Apart from consolidation-driven optimisation of central government institutions (rationalisation of administrative bodies, concentration of support functions, cutting staff numbers and remuneration), few commendable public administration reform measures have been implemented in recent years. A weak common public human resource management policy, lack of career development planning, and uncompetitive remuneration result in relatively high staff turnover and ultimately risk sub-standard policy-making. In this context, the Commission has repeatedly encouraged the authorities to review the unified wage grid set-up, possibly inviting external expertise to ensure adequate pay for the low-level job categories and reward the best performers in middle and senior management.

In February 2013, the government approved a concept paper for the public administration's human resource development, which includes staff recruitment, assessment, rotation, mobility, career development and special trainings for top managers. However, the timetable for implementation seems overly long and does not include targets to monitor progress. Also, municipalities are exempt from these proposals. In the absence of a strategic policy framework and political ownership, the 2007-13 European Social Fund investment (EUR 22.9 million) in building administrative capacity has not been fully effective.

Latvia has demonstrated good Structural Funds and Cohesion Fund absorption progress, partly due to close monitoring in the framework of the BoP assistance programme. However, significant delays have occurred as regards large EU co-financed projects (reconstruction works in Riga airport and port, east-west road network, purchase of new railway carriages, etc.), mainly due to public procurement procedures, insufficient administrative capacity in line ministries, and lack of bank financing. In light of experience from the 2007-13 period, further streamlining of the national management system for European Structural and Investment Funds (ESIF) and simplification of procedures for final beneficiaries is expected.

Compared to the EU average, corruption remains an issue. On the positive side, according to the World Economic Forum Global Competitiveness Index 2012–13 some progress has been made in the related sub-indicators on 'wastefulness of government spending' and 'favouritism in decisions by officials'. The Corruption Perceptions Index of Transparency International ranks Latvia 21st out of 28 EU countries.

Inefficiencies in the civil justice system have a negative impact on business and the economic environment, as they increase the risk and cost of doing business. According to the EU Justice Scoreboard, the Latvian judicial system combines several unfavourable factors, such as lengthy proceedings required to solve civil and commercial cases in first instance and low clearance rates that lead to an increase in the backlog of court cases[17]. Moreover, many cases do not get resolved at first instance, which creates delays and backlogs at all instances, up to the Supreme Court. These shortcomings are confirmed by the findings of the World Economic Forum Global Competitiveness Index 2012–13, which ranks Latvia 106th out of 144 countries for the sub-indicator *'efficiency of legal framework in settling disputes*'.

Positive steps to improve the efficiency and quality of the system have been taken recently, but it is too early to assess their impact. As regards measures adopted to render the system more efficient, amendments to the Law on Judicial Power should lead to the introduction of pure instance systems in the coming years (the Supreme Court Chambers will be eliminated). In parallel, amendments to civil, administrative and criminal procedural law have been proposed and partly implemented. An evaluation of the effectiveness of proceedings and a procedure for the court cost methodology will be undertaken by mid-2013. These amendments are expected to increase efficiency by introducing wider application of written procedures, limitations on producing new evidence, possibilities for appeal, choice of courts, etc. Amendments to certain aspects of the Law on Insolvency have been approved in February 2013. However, it appears that some of the more controversial aspects like the role of insolvency practitioners, their responsibilities with regard to the judges and the effective liquidation of assets still warrant further action.

There are also concerns with regard to human resource management and professional development within the judiciary. A professional evaluation process for judges started in January 2013 and should support the establishment of a comprehensive human resources management policy within/by the judiciary. Stronger involvement of the Judicial Council, strengthening the role of senior management positions within the judiciary and more training of judges might be necessary to develop a sustainable solution.

The availability of alternative dispute resolution methods is being improved. The authorities expect the parliament to adopt the new mediation law by July 2012. Awareness and promotion campaigns will be necessary to ensure rapid take-up and consequently impact the workload of traditional courts. A reform is being launched to streamline the system of arbitration courts and improve their quality and credibility.

ICT communication between courts and parties in judicial proceedings has been improved. Video-conferencing and audio recording equipment have been installed, electronic

[17] http://ec.europa.eu/justice/effective-justice/files/justice_scoreboard_communication_en.pdf

publication of judgments and calendars for lawyers will be soon available, and electronic processing of documents for certain procedures (small claims) may soon be implemented.

4. OVERVIEW TABLE

2012 commitments	Summary assessment
Country-specific recommendations (CSRs)	
CSR 1: 1.Ensure planned progress towards the timely correction of the excessive deficit. To this end, implement the budget for the year 2012 as envisaged and achieve the fiscal effort specified in the Council recommendation under the Excessive Deficit Procedure. Thereafter, implement a budgetary strategy, supported by sufficiently specified structural measures, for the year 2013 and beyond, to make sufficient progress towards the medium-term budgetary objective (MTO), and to respect the expenditure benchmark. Use better than expected cyclical revenue to reduce government debt.	**Significant progress.** The general government deficit decreased in 2012 to the level of 1.2% of GDP, which is significantly better than was envisaged in the 2012 programme. As the structural balance improved substantially in 2012, partly reflecting measures to increase tax efficiency, Latvia also reached its MTO in that year. However, contrary to the CSR, the 2012 budget was not implemented as envisaged, as the standard VAT rate was lowered in mid-2012 and the supplementary budget raising expenditure targets were adopted in the second half of the year.
CSR 2: Implement measures to shift taxation away from labour to consumption, property, and use of natural and other resources while improving the structural balance; ensure adoption of the Fiscal Discipline Law and develop a medium term budgetary framework law to support the long-term sustainability of public finances; restore contributions to the mandatory funded private pension scheme at 6% of gross wages from 2013.	**Some progress.** Latvia has reduced taxes on labour and plans further steps in this regard in 2014-15. However, focus on low-wage earners has been insufficient. The Fiscal Discipline Law was approved by parliament in January 2013 and entered into force on 6 March 2013, and the first medium-term budget law under the new framework is expected in the second half of 2013. Latvia has increased contributions to the mandatory funded private pension scheme, although the increases were more gradual than prescribed by the CSR.
CSR 3: Take measures to reduce long-term and youth unemployment by fighting early school leaving, promoting more efficient vocational education and training and its apprenticeship component, enhancing the quality, coverage and effectiveness of active labour market policy and its training component and through an effective wage subsidy scheme.	**Some progress.** Latvia has partially implemented the CSR by taking the following steps: increased coverage of ALMPs; development of new ALMP measures; modernisation of VET schools; and others. However, since youth and long-term unemployment is still high, further work is necessary. Also, several measures are at an early stage of implementation. There is scope for further action as regards promoting apprenticeships within VET and implementing the planned VET reforms.
CSR 4: Tackle high rates of poverty and social exclusion by reforming the social assistance system to make it more efficient, while better protecting the poor. Ensure better targeting and increase incentives to work.	**No progress.** There has been little progress in addressing the problems of social assistance and some steps (abolishing central government financing for GMI; reduction of the GMI amount) go against the spirit of the CSR.
CSR 5: Further encourage energy efficiency by implementing measures and providing incentives for reducing energy costs and shifting consumption towards energy-efficient products, including vehicles, buildings and heating systems. Promote competition in major energy networks and improve connectivity with EU energy networks.	**Some progress.** Progress achieved on liberalising the electricity market and integration in the regional market includes the following steps: regulated prices for industrial customers have been removed (not yet for households); Latvia will join the regional electricity trading area of Nordic countries on 3 June. Some progress was identified regarding energy network connections, as essential projects are under development in cooperation with other countries in

	the region. Limited progress was achieved on gas infrastructure and markets, and regional discussions continue. Some progress was made on energy efficiency. Delivery of the 40 % RES target by 2020 requires further work, including on the set-up of a stable and predictable support framework. As transport is the sector with most greenhouse gas emissions, additional measures may be needed to re-design public and urban transport systems, adapt public transport to renewable energy sources, increase electrification of railway lines, and address vehicles' poor fuel efficiency.
CSR 6: Take measures to improve management and efficiency of the judiciary, in particular to reduce the backlog and length of procedures. Take steps to improve the insolvency regime and the mediation laws.	**Some progress.** The following measures have been taken to improve the efficiency of the judiciary: the Law on Judicial Power; amendments to aspects of the Insolvency Law; introduction of a professional evaluation of judges; new Law on Mediation; and improvement of ICT facilities. The results of these measures cannot be assessed at such an early stage. However, the following challenges have not been addressed: the need to ensure proper interpretation of the insolvency law; continuing measures that further improve the quality of the judiciary; and establishing a comprehensive policy on human resources.
CSR 7: Continue reforms in higher education, inter alia, by implementing a new financing model that rewards quality, strengthens links with market needs and research institutions, and avoids fragmentation of budget resources. Design and implement an effective research and innovation policy encouraging companies to innovate, including via tax incentives, upgrading infrastructure and rationalising research institutions.	**Some progress.** The Ministry of Education and Science has proposed several reforms. Although most reform plans are at an early stage, they appear ambitious and relevant. If properly implemented, they will have a significant positive impact on the quality of higher education and the economy's innovation potential. Further efforts are needed to modernise and rationalise research and research institutions, based on independent external assessment. Such assessment should support future national and EU investment. The National Industrial Policy is expected to provide direction on cross-cutting innovation policy and promote cooperation between private-sector companies and research institutions. Substantial efforts are necessary to develop and apply the Smart Specialisation Strategy promoting innovation at company level and providing links to research and education.
Europe 2020 (national targets and progress)	
Employment rate target:	The employment rate was 65.0 % in 2010, 66.3% in 2011, and 68.2% in 2012.
R&D target: 1.5 % of GDP	The R&D target is very ambitious. In order to reach it, Latvia needs an average annual growth rate of 9% for R&D expenditure.
Greenhouse gas (GHG) national emissions target: limited increase of 17 % (compared to 2005 emissions, ETS emissions not covered by this national target)	The change in non-ETS greenhouse gas emissions between 2005 and 2011 was +4 %. According to the national projections submitted in 2011, emission will increase by 18 % in 2020 compared to 2005.

	The target is consequently expected to be missed by a gap of 1 percentage point (% of 2005 emissions).
Renewable energy target: 40% Share of renewable energy in the transport sector: 10%	Share of total renewable energy in gross final energy consumption was 33.1% in 2011 and 4.8% in the transport sector. (Source: Eurostat. April 2013. For 2011, only formally reported biofuels compliant with Art. 17 and 18 of Directive 2009/28/EC are included).
Indicative national energy efficiency target for 2020: primary energy savings in 2020 of 0.670 Mtoe (28 PJ). This implies reaching a 2020 level of 5.23 Mtoe primary consumption and 4.35 Mtoe final energy consumption.	Latvia has set an indicative national energy efficiency target in accordance with Articles 3 and 24 of the Energy Efficiency Directive (2012/27/EU). It has also expressed it, as required, in terms of an absolute level of primary and final energy consumption in 2020 and has provided information on the basis on which data this has been calculated
Early school leaving target: 13.4%	The early school leaving rate was 13.3% in 2010, 11.6% in 2011, and 10.5% in 2012. Progress has been made and the target has been achieved. The government plans to set a revised target of 10%.
Tertiary education target: 34-36%	The tertiary attainment rate was 32.3% in 2010, 35.9% in 2011, and 37.0% in 2012. Significant progress has been made and the target has been achieved. Women perform almost twice as well as men: 48.1% against 26% in 2012.
Risk of poverty or social exclusion target: reduce the number of people at risk-of-poverty and/or living in jobless households by 121,000	Attainment in 2010: 54,000 Attainment in 2011: 96,000

5. ANNEX

Table I. Macroeconomic indicators

	1995-1999	2000-2004	2005-2009	2010	2011	2012	2013	2014
Core indicators								
GDP growth rate	4.2	7.4	2.0	-0.9	5.5	5.6	3.8	4.1
Output gap [1]	-1.6	0.7	3.4	-11.4	-5.7	-1.2	0.6	1.7
HICP (annual % change)	4.8	3.2	8.4	-1.2	4.2	2.3	1.4	2.1
Domestic demand (annual % change) [2]	7.3	8.6	0.5	-0.5	11.3	3.3	4.4	4.9
Unemployment rate (% of labour force) [3]	16.6	12.4	9.9	19.8	16.2	14.9	13.7	12.2
Gross fixed capital formation (% of GDP)	18.8	25.3	29.9	18.2	21.3	23.5	24.3	25.4
Gross national saving (% of GDP)	15.6	19.1	20.5	22.8	23.0	24.2	24.5	24.9
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-0.9**	**-1.9**	**-3.1**	**-8.1**	**-3.6**	**-1.2**	**-1.2**	**-0.9**
Gross debt	**12.4**	**13.9**	**17.8**	**44.4**	**41.9**	**40.7**	**43.2**	**40.1**
Net financial assets	**9.5**	**8.9**	**2.1**	**-13.7**	**-14.8**	**n.a**	**n.a**	**n.a**
Total revenue	37.6	33.9	35.5	35.3	34.9	35.2	34.3	33.8
Total expenditure	38.5	35.9	38.6	43.4	38.4	36.4	35.5	34.7
of which: Interest	0.9	0.8	0.7	1.4	1.5	1.3	1.5	1.6
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**-3.8**	**-5.4**	**-4.1**	**13.4**	**6.2**	**5.7**	**4.5**	**4.1**
Net financial assets; non-financial corporations	**-46.2**	**-81.6**	**-91.3**	**-108.3**	**-103.8**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**-5.2**	**-1.2**	**0.3**	**11.7**	**11.3**	**n.a**	**n.a**	**n.a**
Gross capital formation	18.4	23.7	23.4	13.9	19.2	19.7	20.4	21.4
Gross operating surplus	23.6	32.9	30.3	32.3	32.5	35.6	36.3	36.6
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**-1.0**	**-0.2**	**-3.6**	**-0.4**	**-3.0**	**-3.3**	**-2.5**	**-2.7**
Net financial assets	**28.2**	**34.4**	**16.0**	**10.9**	**14.9**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	33.9	33.9	41.3	38.2	37.8	38.1	37.7	37.3
Net property income	7.1	11.8	6.3	4.9	4.9	5.3	3.9	4.7
Current transfers received	16.6	18.3	17.4	19.1	16.3	16.9	16.4	15.4
Gross saving	0.3	1.2	1.0	1.6	-1.0	-1.1	-0.1	-0.2
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**-5.7**	**-7.5**	**-10.7**	**4.9**	**-0.2**	**1.3**	**0.9**	**0.4**
Net financial assets	**14.9**	**40.2**	**73.9**	**101.5**	**94.5**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	-7.6	-11.0	-14.3	-1.4	-4.8	-3.3	-3.8	-4.5
Net primary income from the rest of the world	0.3	-0.4	-0.2	2.0	0.5	0.0	0.1	0.0
Net capital transactions	0.1	0.6	1.7	1.9	2.1	3.0	3.0	3.0
Tradable sector	53.2	52.0	47.0	50.9	52.4	52.6	n.a	n.a
Non tradable sector	35.2	37.7	42.0	38.8	37.2	36.8	n.a	n.a
of which: Building and construction sector	5.0	5.8	7.8	4.7	4.9	5.5	n.a	n.a
Real effective exchange rate (index, 2000=100)	90.6	95.5	133.7	131.4	133.6	131.8	131.5	132.0
Terms of trade goods and services (index, 2000=100)	96.3	97.8	101.2	101.7	105.0	103.7	103.7	103.7
Market performance of exports (index, 2000=100)	93.0	88.6	99.8	103.6	106.1	110.5	112.9	113.8

Notes:

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

[2] The indicator on domestic demand includes stocks.

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

Source:

Commission services' 2013 spring forecasts (COM); Convergence programme (CP).

Table II. Comparison of macroeconomic developments and forecasts

	2012		2013		2014		2015	2016
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	5.6	5.6	3.8	4.0	4.1	4.0	4.0	4.0
Private consumption (% change)	5.4	5.4	3.9	4.1	4.1	4.0	4.0	4.0
Gross fixed capital formation (% change)	12.3	12.3	6.9	5.2	8.1	6.0	6.0	6.0
Exports of goods and services (% change)	7.1	7.1	4.6	5.3	6.2	5.9	5.8	5.9
Imports of goods and services (% change)	3.1	3.1	5.5	5.2	7.2	6.0	6.0	6.0
Contributions to real GDP growth:								
- Final domestic demand	6.8	6.8	4.7	4.3	5.3	4.5	4.6	4.6
- Change in inventories	-3.2	-3.2	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	2.0	2.0	-0.9	-0.3	-1.2	-0.5	-0.6	-0.6
Output gap[1]	-1.2	-0.9	0.6	1.3	1.7	2.7	3.8	4.5
Employment (% change)	2.6	2.8	1.9	1.4	2.2	1.2	1.3	1.3
Unemployment rate (%)	14.9	14.9	13.7	12.6	12.2	11.3	9.9	8.7
Labour productivity (% change)	2.9	2.7	1.9	2.5	1.9	2.8	2.7	2.6
HICP inflation (%)	2.3	2.3	1.4	1.5	2.1	2.3	2.2	2.0
GDP deflator (% change)	3.0	3.0	1.9	1.5	2.2	2.3	2.2	2.0
Comp. of employees (per head, % change)	3.9	3.9	3.1	4.2	3.8	5.0	4.9	4.7
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1.3	1.3	0.9	0.9	0.4	0.9	-0.7	-0.8

Note:

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

Source :

Commission services' 2013 spring forecasts (COM); Convergence programme (CP).

Table III. Composition of the budgetary adjustment

(% of GDP)	2012	2013		2014		2015	2016	Change: 2012-2016
	COM	COM	CP	COM[1]	CP	CP	CP	CP
Revenue	**35.2**	**34.3**	**35.2**	**33.8**	**33.8**	**30.9**	**31.2**	**-4.0**
of which:								
- Taxes on production and imports	11.6	11.4	11.4	11.5	11.2	11.0	10.8	-0.8
- Current taxes on income, wealth, etc.	7.7	7.5	7.6	7.1	7.1	6.7	6.6	-1.1
- Social contributions	8.6	8.1	8.2	8.1	8.1	7.7	7.5	-1.1
- Other (residual)	7.4	7.3	8.0	7.0	7.4	5.5	6.3	-1.1
Expenditure	**36.4**	**35.5**	**36.3**	**34.7**	**34.7**	**31.9**	**32.0**	**-4.4**
of which:								
- Primary expenditure	35.1	34.0	34.8	33.1	33.1	30.4	30.6	-4.5
of which:								
Compensation of employees	9.1	9.0	8.7	8.9	8.4	7.9	7.5	-1.6
Intermediate consumption	6.8	6.7	5.9	6.6	5.7	5.3	4.9	-1.9
Social payments	10.3	9.9	10.4	9.5	9.8	9.4	8.7	-1.6
Subsidies	0.8	0.6	0.7	0.6	0.9	0.8	1.0	0.2
Gross fixed capital formation	3.9	3.8	3.5	3.6	2.9	2.3	2.2	-1.7
Other (residual)	4.3	4.0	5.5	3.9	5.5	4.6	6.2	1.9
- Interest expenditure	1.3	1.5	1.5	1.6	1.6	1.5	1.4	0.1
General government balance (GGB)	**-1.2**	**-1.2**	**-1.1**	**-0.9**	**-0.9**	**-0.9**	**-0.9**	**0.3**
Primary balance	**0.1**	**0.3**	**0.4**	**0.6**	**0.8**	**0.6**	**0.6**	**0.5**
One-off and other temporary measures	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.5
GGB excl. one-offs	**-0.7**	**-1.2**	**-1.1**	**-0.9**	**-0.9**	**-0.9**	**-0.9**	**-0.2**
Output gap[2]	-1.2	0.6	1.3	1.7	2.7	3.8	4.5	5.7
Cyclically-adjusted balance[2]	-0.8	-1.4	-1.5	-1.5	-1.7	-2.1	-2.3	-1.5
Structural balance (SB)[3]	**-0.3**	**-1.4**	**-1.5**	**-1.5**	**-1.7**	**-2.1**	**-2.3**	**-2.0**
Change in SB	*1.3*	*-1.0*	*-1.2*	*-0.1*	*-0.2*	*-0.3*	*-0.2*	-
Two year average change in SB	*1.3*	*0.1*	*0.0*	*-0.6*	*-0.7*	*-0.3*	*-0.3*	-
Structural primary balance[3]	1.0	0.1	0.0	0.1	-0.1	-0.6	-0.9	-1.9
Change in structural primary balance		*-0.9*	*-1.0*	*0.0*	*-0.1*	*-0.4*	*-0.3*	-
Expenditure benchmark								
Applicable reference rate[4]	-0.12	1.18	1.18	-0.05	-0.05	-0.05	-0.05	-
Deviation[5,6] (% GDP)	-0.8	0.4	0.9	1.1	0.5	0.4	0.3	-
Two-year average deviation (% GDP)	-2.6	-0.2	-0.6	0.7	0.7	0.4	0.3	-

Notes*:*

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

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

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

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

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

[6] The estimate of discretionary revenue measures in the Table 2c of the convergence programme of Latvia excludes the incremental impact of the systemic pension reform, whereas this impact is included in the Commission's estimate of discretionary revenue measures.

Source :

Convergence programme (CP); Commission services' 2013 spring forecasts (COM); Commission services' calculations.

Table IV. Debt dynamics

(% of GDP)	Average 2007-2011	2012	2013		2014		2015	2016
			COM	CP	COM	CP	CP	CP
Gross debt ratio[1]	**30.4**	**40.7**	**43.2**	**44.5**	**40.1**	**41.0**	**36.4**	**34.6**
Change in the ratio	6.2	-1.2	2.6	3.8	-3.1	-3.5	-4.6	-1.8
Contributions[2] *:*								
1. Primary balance	**4.1**	**-0.1**	**-0.3**	**-0.4**	**-0.6**	**-0.8**	**-0.6**	**-0.6**
2. "Snow-ball" effect	**0.6**	**-2.0**	**-0.7**	**-0.6**	**-1.0**	**-0.9**	**-0.9**	**-0.6**
Of which:								
Interest expenditure	1.1	1.3	1.5	1.5	1.6	1.7	1.5	1.5
Growth effect	0.4	-2.1	-1.5	-1.5	-1.7	-1.7	-1.5	-1.4
Inflation effect	-0.9	-1.1	-0.7	-0.6	-0.9	-1.0	-0.9	-0.7
3. Stock-flow adjustment	**1.5**	**1.0**	**3.7**	**4.9**	**-1.4**	**-1.7**	**-3.1**	**-0.6**
Of which:								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

	2012	2013		2014		2015	2016
		COM / CP[3]	CP[4]	COM / CP[3]	CP[4]	CP	CP
Gap to the debt benchmark[5,6]	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.
Structural adjustment[7]	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.
To be compared to:							
Required adjustment[8]	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.

Notes:

[1]End of period.

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

[3] Assessment of the consolidation path set in CP assuming growth follows the COM forecasts.

[4]Assessment of the consolidation path set in the CP assuming growth follows the CP projections.

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

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

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

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

Source :

Convergence programme (CP); Commission services' spring 2013 forecasts (COM); Commission services' calculations.

Table V. Sustainability indicators

	LV		EU27	
	No-policy change scenario	Programme (SCP) scenario	No-policy change scenario	Programme (SCP) scenario
S2	-1.0	-0.1	3.0	1.3
of which:				
Initial budgetary position (IBP)	0.9	1.3	0.8	-0.9
Long-term cost of ageing (CoA)	-1.8	-1.4	2.2	2.2
of which:				
Pensions	-1.8	-1.3	1.0	1.1
Health care	0.4	0.4	0.9	0.8
Long-term care	0.2	0.2	0.6	0.6
Others	-0.7	-0.7	-0.4	-0.3
S1 (required adjustment)*	-3.0	-2.5	2.2	0.5
of which:				
Initial budgetary position (IBP)	-0.4	0.8	0.0	-1.8
Debt requirement (DR)	-1.2	-1.8	1.9	1.9
Long-term cost of ageing (CoA)	-1.4	-1.5	0.3	0.4
S0 (risk for fiscal stress)**	0.24		:	
Debt, % of GDP (2012)	40.7		87.0	
Age-related expenditure, % of GDP (2012)	17.6		25.8	

Note:
The 'No-policy change' scenario depicts the sustainability gap under the assumption that the budgetary position evolves according to the Commissions' spring 2013 forecast until 2014. The 'Programme (SCP)' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented.
* The required adjustment of the primary balance until 2020 to reach a public debt of 60% of GDP by 2030.
** The critical threshold for the S0 indicator is 0.44.

Source :
Commission services; 2013 stability programme.

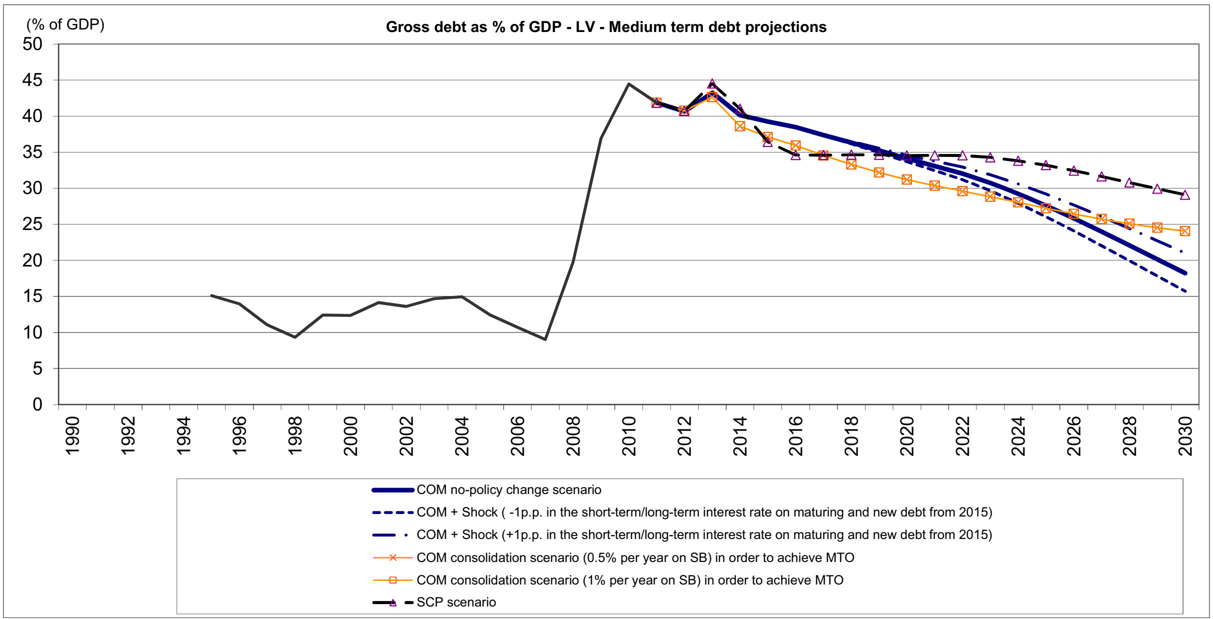

Table VI. Taxation indicators

	2002	2006	2008	2009	2010	2011
Total tax revenues (incl. actual compulsory social contributions, % of GDP)	28.6	30.6	29.2	26.6	27.2	27.6
Breakdown by economic function (% of GDP)[1]						
Consumption	10.5	12.6	10.5	10.2	10.6	10.5
of which:						
- VAT	6.7	8.6	6.7	6.0	6.6	6.8
- excise duties on tobacco and alcohol	1.2	1.3	1.5	1.6	1.5	1.4
- energy	1.8	2.0	1.7	2.1	2.0	1.9
- other (residual)	0.8	0.7	0.6	0.6	0.5	0.4
Labour employed	14.7	14.6	14.4	13.7	14.0	13.5
Labour non-employed	0.1	0.1	0.1	0.2	0.3	0.3
Capital and business income	2.2	2.4	3.3	1.7	1.2	1.8
Stocks of capital/wealth	1.1	0.8	0.9	0.9	1.2	1.4
p.m. Environmental taxes[2]	2.3	2.4	2.0	2.3	2.4	2.5
VAT efficiency[3]						
Actual VAT revenues as % of theoretical revenues at standard rate	48.3	64.6	49.2	38.0	42.8	43.2

Note:

1 Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2013) Taxation trends in the European Union, for a more detailed explanation.

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

3 The VAT efficiency is measured via the VAT revenue ratio. The VAT revenue ratio is defined as the ratio between the actual VAT revenue collected and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). See European Commission (2012), Tax reforms in EU Member States, European Economy 6/2012 and Taxation Papers 34/2012 for a more detailed explanation.

Source: Commission

Table VII. Financial market indicators

	2008	2009	2010	2011	2012
Total assets of the banking sector (% of GDP)	140.2	161.8	168.5	146.0	129.5
Share of assets of the five largest banks (% of total assets)	70.2	69.3	60.4	59.6	…
Foreign ownership of banking system (% of total assets)	68.3	69.2	…	…	…
Financial soundness indicators:					
- non-performing loans (% of total loans)[1)]	2.1	14.3	15.9	13.9	9.6
- capital adequacy ratio (%) [1)]	11.0	13.7	13.9	16.5	16.7
- return on equity (%) [1), 2)]	2.9	-50.6	-19.7	5.1	22.2
Bank loans to the private sector (year-on-year % change)	9.8	-6.8	-6.7	-4.9	-1.0
Lending for house purchase (year-on-year % change)	4.8	-4.0	-4.1	-5.1	-4.4
Loan to deposit ratio	278.4	254.7	225.3	201.2	173.8
CB liquidity as % of liabilities	3.0	0.7	0.0	0.0	0.0
Banks' exposure to countries receiving official financial assistance (% of GDP)	…	…	…	…	…
Private debt (% of GDP)	89.5	103.1	98.8	80.8	…
Gross external debt (% of GDP)[3)]					
- Public	8.7	25.5	32.4	31.9	31.3
- Private	38.6	47.7	45.7	44.4	41.9
Long term interest rates spread versus Bund (basis points)*	2.4	9.1	7.6	3.3	3.1
Credit default swap spreads for sovereign securities (5-year)*	790.1	703.6	358.8	235.6	213.9

Notes:

[1)] Latest data (September 2012).

[2)] After extraordinary items and taxes.

[3)] Latest data 2012Q3.

* Measured in basis points.

Source :

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

Table VIII. Labour market and social indicators

Labour market indicators	2007	2008	2009	2010	2011	2012
Employment rate (% of population aged 20-64)	75.2	75.8	67.1	65.0	66.3	68.2
Employment growth (% change from previous year)	3.6	0.9	-13.2	-4.8	-8.1	2.6
Employment rate of women (% of female population aged 20-64)	70.7	72.1	66.8	64.9	65.3	66.4
Employment rate of men (% of male population aged 20-64)	80.1	79.7	67.4	65.1	67.5	70.2
Employment rate of older workers (% of population aged 55-64)	57.7	59.4	53.2	48.2	50.5	52.8
Part-time employment (% of total employment, 15 years and more)	6.4	6.3	8.9	9.7	9.2	9.4
Part-time employment of women (% of women employment, 15 years and more)	8.0	8.1	10.2	11.4	10.9	11.6
Part-time employment of men (% of men employment, 15 years and more)	4.9	4.5	7.5	7.8	7.3	7.1
Fixed term employment (% of employees with a fixed term contract, 15 years and more)	4.2	3.3	4.3	6.8	6.6	4.7
Transitions from temporary to permanent employment	2.5	1.3	1.1	1.9	2.7	:
Unemployment rate1 (% of labour force, age group 15-74)	6.5	8.0	18.2	19.8	16.2	14.9
Long-term unemployment rate2 (% of labour force)	1.7	2.1	4.9	8.9	8.8	7.8
Youth unemployment rate (% of youth labour force aged 15-24)	11.9	14.5	36.2	37.2	31.0	28.4
Youth NEET rate (% of population aged 15-24)	11.8	11.4	17.4	17.8	16.0	14.9
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	15.1	15.5	13.9	13.3	11.6	10.5
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	25.6	27.0	30.1	32.3	35.9	37.0
Formal childcare (from 1 to 29 hours; % over the population less than 3 years)	2.0	2.0	2.0	1.0	1.0	:
Formal childcare (30 hours or over; % over the population less than 3 year)	14.0	12.0	13.0	15.0	14.0	:
Labour productivity per person employed (annual % change)	5.8	-4.2	-5.3	4.0	14.8	2.9
Hours worked per person employed (annual % change)	-1.3	-4.3	-2.9	-0.8	0.9	-0.8
Labour productivity per hour worked (annual % change; constant prices)	7.2	0.1	-2.4	4.8	13.8	3.8
Compensation per employee (annual % change; constant prices)	11.9	2.4	-11.6	-5.6	14.2	0.6
Nominal unit labour cost growth (annual % change)	27.7	20.7	-7.9	-10.4	2.1	2.8
Real unit labour cost growth (annual % change)	5.8	6.9	-6.7	-9.2	-3.6	-0.2

Notes:

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

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

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

Expenditure on social protection benefits (% of GDP)	2006	2007	2008	2009	2010
Sickness/Health care	3.77	3.39	3.68	3.92	3.66
Invalidity	0.87	0.74	0.92	1.30	1.35
Old age and survivors	5.77	5.03	5.69	7.88	9.42
Family/Children	1.21	1.17	1.39	1.73	1.49
Unemployment	0.52	0.41	0.51	1.59	1.31
Housing and Social exclusion n.e.c.	0.10	0.13	0.17	0.13	0.14
Total	12.36	10.98	12.47	16.69	17.60
of which: means tested benefits	0.19	0.19	0.25	0.32	0.00
Social inclusion indicators	**2007**	**2008**	**2009**	**2010**	**2011**
At-risk-of-poverty or social exclusion[1] (% of total population)	36.0	33.8	37.4	38.1	40.4
At-risk-of-poverty or social exclusion of children (% of people aged 0-17)	33.9	33.2	38.0	42.0	44.6
At-risk-of-poverty or social exclusion of elderly (% of people aged 65+)	50.3	58.1	55.5	37.7	32.9
At-Risk-of-Poverty rate[2] (% of total population)	21.2	25.6	25.7	21.3	19.1
Severe Material Deprivation[3] (% of total population)	24.9	19.0	21.9	27.4	31.4
Share of people living in low work intensity households[4] (% of people aged 0-59)	6.1	5.1	6.7	12.2	12.6
In-work at-risk-of poverty rate (% of persons employed)	9.7	11.0	11.2	9.7	9.4
Impact of social transfers (excluding pensions) on reducing poverty	22.1	15.2	15.2	26.8	30.0
Poverty thresholds, expressed in national currency at constant prices[5]	1400	1844	1819	1466	1364
Gross disposable income (households)	8555	10338	8690	8143	8678
Relative median poverty risk gap (60% of median equivalised income, age: total)	24.6	28.6	28.9	29.4	31.8

Notes:

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

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

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

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

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

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

Table IX. Product market performance and policy indicators

Performance indicators	2003-2007	2008	2009	2010	2011	2012
Labour productivity[1] total economy (annual growth in %)	6.9	-4.2	-5.3	4.0	14.8	2.9
Labour productivity[1] in manufacturing (annual growth in %)	5.9	-5.8	1.3	18.2	24.3	5.0
Labour productivity[1] in electricity, gas, steam and air conditioning supply (annual growth in %)	9.3	-22.8	3.2	13.0	3.9	n.a.
Labour productivity[1] in the construction sector (annual growth in %)	3.9	-5.1	11.0	-14.5	19.6	10.1
Total number of patent[2] applications per million of labour force	12.1	18.8	20.3	22.8	n.a.	n.a.
Policy indicators	**2003-2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Enforcing contracts[3] (days)	280	279	309	309	369	469
Time to start a business[3] (days)	16	16	16	16	16	16
R&D expenditure (% of GDP)	0.5	0.6	0.5	0.6	0.7	n.a.
Tertiary educational attainment (% of 30-34 years old population)	20.0	27.0	30.1	32.3	35.9	36.5
Total public expenditure on education (% of GDP)	5.12	5.75	5.64	5.01	n.a.	n.a.
	2007	**2008**	**2009**	**2010**	**2011**	**2012**
Product market regulation[4], Overall (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Product market regulation[4], Retail (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Product market regulation[4], Network Industries[5] (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Notes:

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

[2] Total number of patent applications to the European Patent Office (EPO) per million of labour force

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

[4] The methodologies of the product market regulation indicators are presented in detail on the website http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html. The latest available product market regulation indicators refer to 2003 and 2008, except for Network Industries.

[5] Aggregate Energy, Transport and Communications Regulation (ETCR).

*figure for 2007.

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

Table X. Green Growth

		2002-2006	2007	2008	2009	2010	2011
Green Growth performance							
Macroeconomic							
Energy intensity	kgoe / €	0.38	0.31	0.31	0.36	0.38	0.33
Carbon intensity	kg / €	0.97	0.80	0.79	0.90	1.00	n.a.
Resource intensity (reciprocal of resource productivity)	kg / €	3.44	3.23	2.81	2.64	n.a.	n.a.
Waste intensity	kg / €	n.a.	n.a.	0.10	n.a.	0.12	n.a.
Energy balance of trade	% GDP	-4.7%	-4.6%	-5.9%	-4.5%	-4.8%	-5.4%
Energy weight in HICP	%	n.a.	11	11	12	14	16
Difference between change energy price and inflation	%	n.a.	3.5	20.4	6.9	0.6	6.9
Environmental taxes over labour taxes	ratio	17.2%	14.3%	13.8%	16.5%	16.7%	n.a.
Environmental taxes over total taxes	ratio	8.6%	6.9%	6.8%	8.6%	8.8%	n.a.
Sectoral							
Industry energy intensity	kgoe / €	0.40	0.38	0.37	0.43	0.45	n.a.
Share of energy-intensive industries in the economy	% GDP	6.6	6.1	6.8	7.1	n.a.	n.a.
Electricity prices for medium-sized industrial users**	€ / kWh	n.a.	0.06	0.07	0.09	0.09	0.10
Gas prices for medium-sized industrial users***	€ / kWh	n.a.	0.03	0.03	0.03	0.03	0.03
Public R&D for energy	% GDP	n.a.	0.02%	0.01%	0.02%	0.01%	0.01%
Public R&D for the environment	% GDP	n.a.	0.01%	0.01%	0.02%	0.01%	0.01%
Recycling rate of municipal waste	ratio	4.3%	5.3%	6.8%	7.8%	9.4%	n.a.
Share of GHG emissions covered by ETS*	%	n.a.	23.6%	23.7%	22.9%	26.9%	25.4%
Transport energy intensity	kgoe / €	n.a.	0.74	0.70	0.74	n.a.	n.a.
Transport carbon intensity	kg / €	n.a.	2.10	1.97	2.03	n.a.	n.a.
Security of energy supply							
Energy import dependency	%	n.a.	61.5%	57.9%	58.8%	41.6%	59.0%
Diversification of oil import sources	HHI	n.a.	0.31	0.31	0.25	0.17	n.a.
Diversification of energy mix	HHI	n.a.	0.29	0.29	0.30	0.31	0.29
Share renewable energy in energy mix	%	n.a.	29.6%	30.0%	36.2%	34.6%	33.8%

Country-specific notes:

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

General explanation of the table items:

Source: Eurostat unless indicated otherwise; ECFIN elaborations indicated below

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

- Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)
- Carbon intensity: Greenhouse gas emissions (in kg CO2 equivalents) divided by GDP (in EUR)
- Resource intensity: Domestic Material Consumption (in kg) divided by GDP (in EUR)
- Waste intensity: waste (in kg) divided by GDP (in EUR)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

*Provisional data (15 April 213). Commission Services and EEA.

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

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