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COMMISSION STAFF WORKING DOCUMENT

2025 Country Report - Latvia

Accompanying the document

Recommendation for a COUNCIL RECOMMENDATION

on the economic, social, employment, structural and budgetary policies of Latvia

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European Commission

Latvia

2025 Country Report



ECONOMIC DEVELOPMENTS AND KEY POLICY CHALLENGES

Latvia's economy is on a path to modest growth

In 2024, the economy faced a recession (-0.4%). This was mostly due to the geopolitical context and perceived uncertainties by both households and companies. Despite pronounced wage growth, private consumption was weak, and the saving rate was very high at 11.3% due to precautionary saving. In addition, foreign investors are holding back investments in Latvia due to geopolitical risks following Russia's full-scale invasion of Ukraine. Private investment was also hampered by high interest rates while some public investments were delayed, in particular under EU co-financed investment programmes. As a result, after solid growth in 2023 (9.9%), investment significantly declined in 2024 (-6.7%). Goods and services export growth was still negative in 2024 due to a weak external environment and a deterioration in cost competitiveness. However, goods and services imports fell faster. In 2024, the economy was mostly supported by public consumption, which remains strong.

A slow recovery is expected in 2025. Solid wage growth should support a further increase in real incomes, which should eventually spill over into consumer spending. Investment is expected to recover in 2025 supported by EU fund inflows, increasing spending on defence and easing financial conditions. In 2025, investment is projected to decrease by 1.2%, before picking up to 2.6% in 2026. After two years of decline, exports could remain weak this year due to the direct impact of US tariffs and the potential exposure of Latvia's main trading partners.

The Latvian labour market is performing well, but shows structural challenges, such as growing labour and skills shortages. After increasing in the first quarter of 2024 to 7.1%, the unemployment rate fell slightly to 6.9% in the last quarter of 2024, while the employment rate (77.4% in 2024) returned to its pre-pandemic level (see Social Scoreboard in Annex 13). As the economy recovers, the unemployment rate is expected to decrease further in 2025 and 2026. In 2024, nominal wages increased by 7.7%. Nominal wage growth is set to reach 5.5% in 2025 and 4.5% in 2026, driven by a tight labour market.

In 2024, energy prices declined quickly, which rapidly pushed down headline inflation. With a broad-based slowdown in price rises for other items in the Harmonised Index of Consumer Prices, inflation fell to 1.4% in 2024. Inflation is set to reach 3% in 2025 and 1.7% in 2026. Following wage trends, services inflation is projected to rise to 5.1% in 2025 and decrease gradually to 3.7% by 2026. Headline inflation excluding energy and unprocessed food was above general headline inflation in 2024 and is set to remain so in 2025, driven by pressures in services and processed food prices. The two figures are likely to converge again by 2026.

Box 1: UN Sustainable Development Goals (SDGs)

Latvia performs well or is improving on SDGs related to productivity (SDGs 4, 9) and macroeconomic stability (SDGs 16, 17) but is moving away from the targets for some SDGs related to environmental sustainability (SDGs 6, 15).

Latvia is well below the EU average and is moving away from the targets on good health and well-being (SDG 3) and on reduced inequality (SDG 10), mainly due to increasing unmet needs for medical care and a wide urban-rural gap for the risk of poverty or social exclusion (see Annex 15).

Public finances are under pressure to fund key priorities

In 2024, the general government budget deficit stood at 1.8% of GDP, down from 2.4% in 2023. In 2024, general government revenue grew faster than expenditure. This was mainly due to strong revenue growth from labour and corporate taxes, including corporate income tax advance payments from the financial sector, other taxes on production as well as additional dividend payments from state owned enterprises. The lower growth of government expenditure was general driven by phase-out of measures to mitigate the impact of high energy prices. The general government deficit is forecast to increase to 3.1% of GDP in 2025, mainly due to weaker revenue growth and increasing current expenditure. In 2026, the government deficit is forecast to remain at 3.1% of GDP. Government debt is expected to rise from 46.8% of GDP in 2024 to 48.6% in 2025, affected by positive stock-flow adjustments and budget deficit, and reach 49.3% in 2026.

The growth of net expenditure both in 2025 and cumulatively since 2024 is projected to be below the recommended maxima. In 2024, net expenditure (¹) in

Latvia grew by 4.5% (see Annex 1). This increase is mainly driven by growth of current expenditure, particularly social benefits (due to continuous rise of the average retirement pension) and compensation of employees (due to the increase in the national minimum wage and higher remuneration for public sector employees). In 2025, net expenditure is forecast by the Commission to grow by 5.7%, which is below the maximum growth rate recommended by the Council (²). The cumulative growth rate of net expenditure in 2024 and 2025 taken together is projected at 10.4%, which is below the maximum growth rate recommended by the Council.

A structural revenue increase may be necessary to keep up with rising spending needs. Latvia's tax revenue remains below the EU average, at 32.9% of GDP in 2023 compared to the EU average

⁽¹⁾ Net expenditure is defined in Article 2(2) of Regulation (EU) 2024/1263 as government expenditure net of (i) interest expenditure, (ii) discretionary revenue measures, (iii) expenditure on programmes of the Union fully matched by revenue from Union funds, (iv) national expenditure on cofinancing of programmes funded by the Union, (v) cyclical elements of unemployment benefit expenditure, and (vi) one-off and other temporary measures.

⁽²⁾ Council Recommendation of 21 January 2025 endorsing the national medium-term fiscal-structural plan of Latvia (OJ C, C/2025/652, 10.2.2025, ELI: http://data.europa.eu/eli/C/2025/652/oj).

of 39.0%. Labour and consumption taxes are Latvia's main revenue sources, whereas taxes on capital, including corporate income tax, tax on income from capital $(^3)$ and taxes on property (⁴), represent a relatively low share of total tax revenue and of GDP compared to other Member States. In 2023, taxes on capital accounted for 3.1% of GDP in Latvia against 8.5% in the EU as a whole. In terms of immovable property taxation, Latvia ranks in the upper-middle section among EU Member States but, at 0.6% of GDP in 2023, revenues were still below the EU average of 0.9%. While this relative overall tax revenue gap might not be an issue per se, it becomes relevant when viewed in the context of the government's ability to sustainably finance policy priorities and provide adequate public services while complying with fiscal rules.

Taxation of sources less detrimental to growth has been only marginally addressed by the recent tax reform. The tax reform that entered into force in January 2025 mainly adjusted the personal income tax system with the aim of simplifying taxation and raising disposable income for most workers. The reform also increased tax rates on income from capital in line with the increase in the standard personal income tax rate (from 20% to 25.5%) (⁵). Furthermore, it made annual income above EUR 200 000, including

- (4) Taxes on immovable property, duties on operations related to real estate, legacies and donations, etc.
- (5) A personal income tax rate of 25.5% rate is applied to annual income not exceeding EUR 105 300; a 33% rate is applied above this threshold (excluding income from capital).

income from capital, subject to a higher personal income tax rate (an additional 3% is applied on top of the standard rate). Nonetheless, these measures are estimated to have rather a minor fiscal impact on capital tax revenue, amounting to less than 0.1% of GDP in 2025 and in 2026. The government is formally committed to transitioning to new land and property values ('cadastral values') for immovable property taxation from 2026, alongside a review of real estate tax rates and the rebate system. The current plan aims to stabilise tax revenue at 0.6% of GDP, approximately 0.2 percentage points below 10-year average the annual and significantly lower than the theoretical revenue under the newly projected cadastral values (⁶).

Improving the current approach to public spending reviews and gradually introducing performance-based budgeting could yield fiscal benefits. Annual expenditure reviews have been carried out since 2016 with the aim of making public spending more effective. However, the current practice has largely been limited to returning most savings (approximately 0.3% of GDP annually) to the line ministries involved in the review process to finance their internal priorities. A potentially better approach could be to redirect the resulting funding to a limited number of priority areas, such as defence, healthcare and social protection. According to the declaration on intended actions by the current government, proposals will be made for improving the principles guiding state budgeting, setting clearer goals for

⁽³⁾ Income from capital gains (disposal of real estate, shares, virtual currency, intellectual property, investment gold, etc.) and income from capital (taxable dividends, interest on deposits, income from investment promissory notes, income derived from the investment account, etc.).

⁽⁶⁾ According to the Ministry of Finance, in 2023 actual real estate tax revenue amounted to EUR 237 million, while theoretical real estate tax revenue under the new projected cadastral values, assuming unchanged tax rates, was estimated at EUR 511 million; https://www.fm.gov.lv/lv/media/18078/download?att achment.

state budget programmes and regularly evaluating the results. As a first step, in February 2025, the Ministry of Finance submitted an informative report on performance-based budgeting in Latvia for government consideration. This initiative aims to ensure more effective and transparent management of state budget funding and to improve the connection between state budget expenditure on the one hand, and the goals and results of sectoral policies on the other hand.

Tackling socio-economic challenges to boost competitiveness

Latvia's GDP per capita is significantly below the EU average, and the pace of convergence with other EU Member States is slowing. In 2024, Latvia's GDP per capita was 71% of the EU average, which is only 5 percentage points higher than in 2019. In addition, its income level is significantly below that of its Baltic peers -GDP per capita for Estonia and Lithuania was, respectively, 79% of the 2023 EU average (down 5 percentage points on 2019) and 87% (up 4 percentage points on 2019). This suggests that key convergence challenges, such as an ageing population, skills shortages, poor health outcomes, weak innovation performance and regional disparities, are hindering faster progress.

Simplifying regulations and increasing investment in research have the potential to improve competitiveness. Latvia's business environment could benefit from regulatory simplification, a reduction in the size of the shadow economy and improved access to finance, particularly for small and medium-sized enterprises. The lack of highly skilled human capital and low public R&D spending are barriers for both performance and research innovation output. Latvia could benefit from

strengthening the resilience of its regions, particularly its eastern border areas by promoting balanced economic development, enhancing security and stability and maximising the use of EU funding for long-term growth (see Section 2 and Annexes 3, 4, 5 and 6).

There is scope for Latvia to more closely align decarbonisation and competitiveness objectives. Latvia would especially benefit from faster deployment of wind and solar energy capacity, which would entail addressing current electricity arid constraints and further expediting and streamlining permitting procedures, including those for the installation of electricity storage capacities. Moreover, considering the already high share of renewable sources in its electricity mix, Latvia could promote further electrification a cost-effective way to as reduce greenhouse gas emissions and bring the benefits of affordable renewable generation to consumers. Finally, climate action in the agri-food and land sectors is essential management to contribute to the broader goal of a climateneutral and resilient EU by 2050. Latvia could step up efforts to foster a transition to more sustainable practices in those sectors (see Section 3 and Annexes 7, 8 and 9).

Latvia's competitiveness is also linked to its social fairness, which remains a challenge. Inadequate social protection leads to persistently high-income inequality and poverty, limiting the opportunities for vulnerable groups as reflected in the social scoreboard accompanying the European Pillar of Social Rights (⁷). The healthcare system is underfunded, resulting in poor

(7)

https://ec.europa.eu/eurostat/cache/dashboard /social-scoreboard/.

health outcomes and losses of working time. The lack of affordable and quality housing in the regions hinders not only social well-being, but also labour mobility (see Section 4 and Annexes 10, 11, 12, 13, 14 and 17).

Box 2: Barriers to private and public investment

Latvia needs more private investment to support economic growth and competitiveness. Several barriers to private investment exist.

- Unfavourable financing conditions. 58% of Latvian enterprises reported the nonavailability of finance as an obstacle to long-term investment in 2024. Private investment has been constrained by high lending rates and stringent collateral requirements.
- Geopolitical risks. Foreign investors are holding back from investing in Latvia following Russia's full-scale invasion of Ukraine.
- Labour market challenges. 83% of Latvian businesses report a lack of skilled staff as a primary obstacle to long-term investment.
- Sluggish innovation performance. Poor R&D incentives and bureaucratic hurdles discourage R&D investment.

Latvia makes effective use of EU funds to supplement national investments, ensuring the advancement of critical infrastructure and reforms, especially given constraints in its national budget. However, barriers to efficient public spending remain. These challenges also act as a bottleneck to the implementation of EU funds:

- Administrative capacity and execution strategies. The pace of implementation of EUfunded projects is slowed by constraints in administrative resources, cumbersome interinstitutional coordination, excessive administrative burden on final beneficiaries and systemic delays in setting national regulatory frameworks for implementation. Certain EU-funded projects may also struggle with low demand at municipal level due to potential future funding needs for maintenance or services.
- Implementation capacity of the construction sector. The construction sector risks limitations in implementation capacity as multiple construction projects happen simultaneously, competing for limited resources such as skilled labour, materials and equipment, slowing down the delivery of public investment. Large investment projects are also affected by administrative hurdles, such as delays in procurement processes, and external factors such as supply chain constraints and increasing costs due to inflation.

The implementation of Latvia's RRP is facing challenges. At present, Latvia has fulfilled 38% of the milestones and targets in its RRP. Accelerating progress and addressing the abovementioned barriers would support timely and effective implementation of the plan.

It remains important to accelerate the implementation of cohesion policy programmes. The mid-term review offers opportunities to speed up progress and better address EU strategic priorities related to competitiveness, defence, housing, water resilience and the energy transition.

While Latvia has leveraged STEP to reallocate some Cohesion Policy resources towards this priority, it can further support the development or manufacturing of critical technologies in the areas of digital and deep tech, clean and resource efficient technologies, and biotechnologies.

INNOVATION, BUSINESS ENVIRONMENT AND PRODUCTIVITY

Latvia's business environment has improved, but the country needs to address ongoing obstacles to achieve stronger economic and productivity growth. A survey carried out in 2024 by the European Investment Bank showed that Latvian companies have become more optimistic about the business environment. Business investments in Latvia are 30% above pre-COVID-19 levels. Latvian firms faced lower obstacles for investment (⁸). Nevertheless, Latvian business still face challenges such as low R&D intensity, limited access to finance, high interest rates, a high regulatory burden, geopolitical risks and a significant shadow economy. Furthermore, while labour productivity and economic efficiency (as measured by total factor productivity) have picked up in recent years, Latvia's productivity level remains not only below the EU average, but also that of its Baltic peers, Estonia and Lithuania. achieve То more robust economic growth, it is essential for Latvia to address these ongoing challenges and bridge the productivity gap.

Boosting innovation and R&D investment

R&D outputs and investment in Latvia are lagging the European average. The European Innovation Scoreboard classifies Latvia as an emerging innovator. Unlike in Member States, most business R&D expenditure (0.3% of GDP) is significantly lower than public R&D spending (0.53% of GDP) and is the lowest in the EU (EU average 1.49% of GDP). The quality of research and innovation (R&I) outputs also remains below the EU average. For example, only 4.55% of scientific publications written in Latvia are within the 10% most-cited top scientific publications (⁹). Innovation output in terms of patents and trademarks is also low, with only patent applications 1.0 per EUR 1 billion of GDP compared to the EU average of 2.8 in 2022 (see Annex 3).

In terms of research activities, Latvia is lagging behind the EU average. In Latvia, there are only a few high-performing public research institutions. However, the consolidation of universities, the creation of the innovation governance model, and the establishment of competence centres (all of which feature in the recovery and resilience plan) could potentially lead to progress in this area. Successful continuation of the reforms in higher education could lead to further improvements. Latvia's R&I capacity is hindered by a shortage of researchers in both the public and private sectors (see Annex 3). This could also negatively impact the R&I system capacity to absorb funds. The relaxation of the Latvian language requirement for academic staff in 2024 may help to attract more researchers from

⁽⁸⁾ https://www.eib.org/en/press/all/2025-069-latviancompanies-see-improved-business-environment-innew-eib-investment-survey.

⁽⁹⁾ DG RTD based on Science-Metrix using data from Scopus (Elsevier) with fractional count and a 2-year citation window.

abroad, although further steps, such as a relaxation for lecturers and assistants. would be beneficial. The number of graduates doctoral and science. technology, engineering and mathematics (STEM) graduates is low and increasing too address the shortage slowly to of researchers in the short or medium term (see Section 4 and Annex 3). The number of doctoral students has already new increased following the new doctoral model (part of recovery and resilience plan). However, their impact on the workforce will only be visible in the long run.

Private R&D investment is very low. Latvia does not currently have corporate R&D tax incentives in place and mostly uses direct funding to support business innovation instead. The lack of incentives for the business sector to distinguish R&D from other types of investment may lead to underreporting R&D investment, of although the low level of innovation output shows the low level of innovation activity. Consideration could be given to introducing indirect funding, such as leveraging public procurement to stimulate broader R&D activity in businesses and improve monitoring.

Improving access to finance

Despite some revival of credit growth in 2024, companies in Latvia use external financing less than their peers in other EU countries. Bank lending to nonfinancial corporations in December 2024 grew by 5.8% year-on-year, thus exceeding the growth rate of nominal GDP. In 2023, loans, listed shares, trade credit and bonds constituted 34% of GDP in Latvia and 54% in the EU. The cost of credit is high: in December 2024, the lending interest rates were 5.22% in Latvia, compared with 4.24% in the euro area (see Annex 5). Cyclical and structural issues constrain lending in Latvia. These issues are reflected in high lending rates and stringent collateral requirements. This is most notable in corporate lending, where interest rate markups have remained high and a large proportion of loans have variable interest rates, resulting in very high lending rates. Market concentration in the banking sector is among the highest in the EU. Spreading information about products, including those provided by smaller banks, and their costs could partly mitigate this problem. Work is underway to facilitate switching for bank customers. For example, in 2024 mortgage loans transfers from one lender to another were simplified and the switching costs for consumers were reduced. A further reduction of switching costs for bank customers could increase competition between banks and reduce high credit costs.

Latvia's capital market is less developed than the EU average or the markets in neighbouring countries. In Q2-2024, stock market capitalisation in Latvia was equal to 1.5% of GDP (for comparison: 67.6% in the EU, 5.8 in Lithuania and 12.7% in Estonia). In 2023, listed shares and bonds accounted for just 1.3% of all funding sources for Latvian non-financial corporations. Moreover, Latvia has only listed bonds for three of its state-owned enterprises, in contrast to Lithuania and Estonia, where they account for slightly more than a third of market capitalisation (see Annex 5). Latvian authorities are working to unify capital markets with other Baltic states. Further harmonising reportina requirements across Baltic capital markets could make the capital market more attractive.

The venture capital sector shows positive signs of development; however, it still

lags the EU average. According to the Dashboard (¹⁰), Capital Markets Union annual investment venture capital amounted to 0.02% of GDP on average between 2021 and 2023, well below the EU average of 0.08%. Venture funds in Latvia often depend on co-investments from the state budget, Latvia's national promotional institution, EU funds, the European Bank for Reconstruction and Development or the European Investment Fund. Even then, Latvian venture capital still encounters difficulties in attracting the necessary level of private capital for the publicly supported hybrid venture capital funds. However, crowdfunding platforms are rather popular, accounting for 0.7% of GDP.

The non-bank financial sector's assets are largely comprised of household retirement savings. At the end of Q2-2024, Latvia's pension savings in all types of pension products (22.3% of GDP) exceeded Lithuania's (11%), and Estonia's (19% in 2019). At the end of 2023, second-pillar (occupational) pension plans had accumulated almost half of the total assets of the non-bank financial sector. Due to the growing contributions to the second-pillar pension scheme, the high return on investment and the licensing of investment platforms in 2021, the role of Latvia's institutional investors has been growing over recent years. Pension funds have contributed to the development of Latvian their capital markets, but domestic investment remains low due to the shallow local financial markets (see Annex 5).

Reducing the administrative burden

Latvia's regulatory framework presents challenges in terms of administrative burden and compliance costs for companies. Currently, there are no requirements for regulators to assess compliance costs in new or existing legislation, and no recent efforts have been made to consolidate or streamline regulations (see Annex 6). Although public participation in the legislative process has increased, the use of policy impact analyses remains below the EU average, indicating gaps in long-term policy evaluation. Public trust in government decisions is relatively low, with only 26% of Latvians believing decisions evidence-based, that are compared to 41% in OECD countries overall $(^{11}).$

The licensing regime in Latvia is slightly more restrictive than the EU average, as indicated by the OECD product market regulation indicator. While an online inventory of permits and licenses is available, regular reviews to assess the need for them are lacking. Most permits and licenses require periodic renewal, contributing to regulatory complexity. In sectors like real estate development, administrative hurdles remain. The potential for simplification in systems such as the Building Information System is identified by the action plan as a way of reducing the administrative burden in the field of real estate development (¹²).

^{(10) &}lt;u>https://finance.ec.europa.eu/document/download/60d966f8-8f3a-4133-a852-</u> <u>de7d6978e387_en?filename=240719-capital-markets-union-indicators_en.pdf</u>

^{(&}lt;sup>11</sup>) OECD Survey on Drivers of Trust in Public Institutions <u>- 2024 Results | OECD</u>

^{(&}lt;sup>12</sup>) <u>https://www.em.gov.lv/lv/jaunums/valdiba-</u> <u>apstiprina-pasakumu-planu-administrativa-sloga-</u> <u>mazinasanai-nekustamo-ipasumu-attistisanas-joma</u>

The regulatory burden is reported as an obstacle to investment. According to the European Investment Bank's Investment Survey 2024 (13), 42% of businesses in Latvia identified business regulation as a major challenge, exceeding the EU average of 32% and levels reported in Estonia (15%) Lithuania (22%). and From а competitiveness perspective, reducing regulatory complexity and ensuring a more predictable business environment are essential to fostering investment.

Formalising the economic activity

Recent assessments reveal a positive break in the growth of the shadow economy over the past four years. According to surveys of company owners and managers (¹⁴), the shadow economy decreased in size in 2023 to 22.9% of GDP, 3.6 percentage points lower than in 2022. This was due to a decrease in the share of underreported business income and in the share of envelope wages. While there are different ways of measuring the size of the shadow economy and it is difficult to establish causality, the persistent focus on policy measures to formalise economic activity seems to have reduced companies' tolerance for the shadow economy and their willingness to participate in it. Also, important but unimplemented measures are carried over from one action plan to the continuity next, ensuring of policy implementation.

Data on taxpayers' ratings show some positive results in the taxpayer structure. The taxpayer rating (a measure under the recovery and resilience plan) is a tool operated by the State Revenue Service aimed at assessing the settlement of tax liabilities of commercial companies. It is comprised of several indicators, e.g. timely submission of reports, status of tax settlement and salary-setting principles. Recent analysis by the State Revenue Service (¹⁵) shows that the proportion of taxpayers with good and overall good settlement of tax liabilities has increased by 0.1% and 2.5% respectively, while the share of inactive taxpayers has decreased by 2.4%. However, these results must be treated with some caution given the relatively short time series.

Building resilient and competitive regions

Latvia could benefit from stepping up efforts to reduce disparities between the capital region and other areas. While some regions show promising growth trajectories based on a mix of traditional sectors, more attention could be paid to developing strong foundations for businesses to thrive by providing quality public services, access to finance and infrastructure, in particular, road, railway Improving and digital connections. connectivity in lagging regions would also strengthen their attractiveness for visitors and talent and would support their competitiveness productivity. and Moreover, the war in Ukraine has had a profound impact on Latvia's eastern border regions disrupting trade, triggering

^{(&}lt;sup>13</sup>) EIB investment survey 2024 Latvia <u>https://www.eiob.org/files/documents/lucalli/202402</u> <u>38 econ eibis 2024 latvia en.pdf</u>.

⁽¹⁴⁾ Shadow Economy Index for the Baltic Countries 2009-2023; <u>https://www.sseriga.edu/sse-riga-</u> <u>shadow-economy-index-shadow-economy-latvia-</u> <u>decreased-2023-229-gdp</u>.

⁽¹⁵⁾ Assessment by the State Revenue Service based on taxpayers rating data; February 2024 and February 2025.

migration and the need for new investments in civil protection and defence. The government recently approved an action plan to boost economic growth in the eastern border regions and strengthen their security. However, given their weakerthan-average economic performance, these regions, especially Latgale, merit additional attention and more investment to support border security and defence, civilian resilience, connectivity, administrative capacity-building and business. Furthermore, the regions have significant untapped potential stemming from the 'green transition', particularly in renewable wind and solar energy deployment, and advances in sustainable transport.

DECARBONISATION, ENERGY AFFORDABILITY AND SUSTAINABILITY

Speeding up renewable energy deployment and electrification

While Latvia already has high а proportion of renewables in its electricity mix, speeding up the deployment of additional solar and wind energy capacity would be beneficial. In 2024, 74% of Latvia's electricity was generated from renewable sources, with hydro accounting for 51% of the total. However, the shares for solar and wind production, at 8% and 4% respectively, were still significantly lower than in Lithuania and Estonia, and below the EU average (¹⁶). Beyond the measures planned under Latvia's recovery and resilience plan, there is ample scope for additional improve grid measures to aueue management (see Annex 8) and to expedite and streamline permitting procedures for new solar and wind energy projects, as well as related storage capacities. On grid queue management, amendments the to Electricity Market Law that entered into force on 1 April 2025 are expected to ease the current bottleneck (¹⁷). Improving the design of national support schemes to provide more long-term predictability is also crucial for developers of large-scale generation facilities.

Promoting electrification across sectors could be a cost-effective way to reduce greenhouse gas emissions and bring the of affordable renewable benefits generation to consumers. Latvia's electrification rate - electricity as a share of final energy consumption – is substantially below the EU average and has stagnated over the past decade (see Annex 8). Given high and increasing share the of renewables in the electricity mix, promoting further electrification across sectors could be an effective strategy to reduce overall greenhouse gas intensity and enhance economic resilience. For example, Latvia could increase electricity's share in final energy consumption for buildings and industry sectors by further supporting electrification under future enerav efficiency schemes. This would help to unlock the potential of electrification to drive decarbonisation and support a cleaner energy system.

Further electrification and a higher rate of renewables in the country's energy mix require solid planning and support for upgrades to the grid, promotion of storage, demand response and marketbased flexibility. Under its recovery and resilience plan and EU cohesion policy programming, Latvia is already investing in expanding, securing and digitalising electricity transmission and distribution networks. The successful synchronisation with the continental European electricity network as of 9 February 2025 strengthens energy security but demands additional efforts to improve grid resilience. The installation of a 60 MW battery energy

^{(&}lt;sup>16</sup>) Ember, Electricity Data Explorer, available at <u>Electricity Data Explorer | Ember.</u>

⁽¹⁷⁾ Amendments to the Electricity Market Law

storage system in Rezekne, co-financed by the Recovery and Resilience Facility, will be a positive development for energy storage. The variability associated with renewable energy generation means that ways must be found to balance energy supply with demand throughout the day. Latvia could benefit from: (i) promoting demandresponse tools, which can adjust energy use in real time to match energy availability; (ii) providing incentives for the installation of batteries or other systems for storing excess energy generated at peak times; and (iii) enhancing the role of independent aggregators of small-scale demand able to provide flexibility over the course of a day and balancing services when needed.

Decarbonising the transport sector

Latvia could intensify its efforts to decarbonise the transport sector, which remains heavily reliant on oil products. The potential for further electrification and decarbonisation is significant in this sector, particularly in road transport, which is one of the largest energy consumers and greenhouse gas emitters in the country (see Annex 7). However, the penetration of electric vehicles, including both full batteryelectric and plug-in hybrid electric vehicles, is relatively low, as is the uptake of vehicles powered by alternative fuels.

The Latvian government is taking some steps in the field of transport, but additional efforts are needed. Some positive measures are in place or in the pipeline: Latvia has adopted taxation policies linking vehicle registration and ownership taxes to CO₂ emissions; the Ministry of Transport is currently working on a proposal for a new Road Charges Act, introducing differentiated toll rates according to the CO₂ emissions of vehicles and a new distance-based levy from 2030; support measures and direct investments are ongoing or at the design phase. Furthermore, the cross-border Rail Baltica project, which aims to strengthen connectivity between the Baltic states and the rest of the EU, is crucial for shifting traffic from road to rail in the interests of sustainability. However, progress has been slow and would benefit from measures to ensure faster implementation. Funds from the Recovery and Resilience Facility were recently allocated for the completion of works in the southern part of Riga Central Railway Station - a big step towards a rail linking Riga International connection Airport to the main Rail Baltica line. Latvia could do more to promote the uptake of electric vehicles, and the production and uptake of renewable and low-carbon fuels for both public and private transport. Retrofitting conventional heavy-duty vehicles, especially buses, with an electric powertrain could be a cost-effective contribution fleet decarbonisation. to Additional investment to expand the network would recharging also be beneficial. On the legislative front, the swift adoption of the Climate Law and Transport Energy Law would help create certainty and stability for market operators and users as they transition to cleaner forms of transport. Lastly, the targeted use of the Social Climate Fund will be essential in supporting vulnerable groups during this transition.

Improving energy efficiency

Significant energy efficiency schemes are currently running or being planned, but Latvia could benefit from stepping up the renovation of its rather old building stock, especially by leveraging additional private funding. The building stock is a major energy consumer in the country and, while energy consumption from the sector has decreased in the past few years, additional efforts are needed to achieve the 2030 eneray efficiency targets (see Annex 8). Moreover, fuel taxes for buildings are much lower than the EU average and so do not provide a sufficient decarbonisation incentive and perpetuate reliance on fossil fuels. The OECD measures this incentive by effective carbon rates (see also Annex 8) which, for buildings, are EUR 7.87 in Latvia compared to EUR 61.49 for the EU as a whole. Most current and planned support schemes are dependent on EU funding, especially via the Recovery and Resilience Facility, EU cohesion funds and the Modernisation Fund. There is scope for attracting additional private funding, by deploying dedicated financial instruments and de-risking options for energy efficiency investments, and by supporting the development of the energy services sector as a key market-enabler for energy efficiency improvements. Moreover, swift drafting and submission of the first draft national building renovation plan by 31 December 2025 will be fundamental (and is required by the Energy Performance Buildings Directive). of The Latvian government plans to have a new Energy Efficiency Law adopted by the end of 2025, which would provide a legal framework for the country to achieve the targets set by relevant EU Directives. Latvia has also recently amended the Law on Residential Property, which should speed up decisionmaking for energy efficiency renovations in multi-apartment buildings.

Sustainable land management

The land use, land-use change and forestry (LULUCF) sector and the agricultural sector continue to be a source of concern, as Latvia's carbon removals are insufficient to meet its 2030 target. Amid increased logging and high greenhouse gas emissions from degraded peatlands, the LULUCF sector has become a net greenhouse gas emitter in recent years. According to the latest projections, Latvia is unlikely to meet its target for net greenhouse gas removals without additional efforts (see Annex 9).

The agriculture, forestry and peat extraction sectors put significant strain natural environment, on the with degraded peatlands being a particular concern. Wetlands, including peatlands, play a significant role in greenhouse gas emissions within Latvia's LULUCF sector, approximately accounting for 38% according to the latest available data. The vast majority of emissions from wetlands are attributable to peat extraction for horticultural purposes. While Latvia's common agricultural policy strategic plan includes some positive measures (see Annex 9), the country would benefit from further initiatives to reduce the environmental intensity of these sectors and from a stronger national regulatory framework for sustainable land management. For instance, Latvia could: (i) implement capacity-building programmes for farmers, land managers and local communities: provide additional (ii) incentives for set-aside and rewetting programmes through compensation schemes; and (iii) enforce sustainable forest management and peat extraction practices. Furthermore, providing farm-level monitoring data and advisory services, and supporting innovative carbon farming startups, could help land sector operators build a compelling business case for transitioning to more sustainable and resilient practices.

Circular economy and waste management

Latvia faces significant challenges in its transition to a circular economy and could benefit from improved wastemanagement policies. In 2023, the country's circular material use rate was less than half the EU average, and resource productivity was also below the EU average (see Annex 7). Improving resource productivity can help to minimise negative impacts on the environment and reduce dependency on volatile raw material markets. Despite significant progress in its waste-management system in the last decade, Latvia still struggles with municipal waste and bio-waste collection and recycling; a significant proportion of municipal waste (44%) is still sent to landfills, putting the country at risk of missing its 2025 reuse and recycling targets and its 2035 landfill reduction target.

The 2021-2027 action plan 'Towards a Circular Economy', which is the main national policy document in this area, marks a positive step towards circularity consumption and different and production patterns. However, the plan lacks quantified targets and a clear strategy to ensure that planned initiatives go beyond niche areas and are effectively integrated into the broader economy and society. In 2024, Latvia introduced a system for bio-waste collection and an extended producer responsibility system for textile products, which is a positive development. Latvia could develop this, for example by increasing municipal waste recycling and improving bio-waste collection bv providing all residents with separate biowaste containers, by raising public awareness through campaigns and by the use of green public extending procurement. Further investments are

necessary to unlock the full potential of a circular economy and address the existing challenges.

Net-zero manufacturing capacity

Latvia's manufacturing capacity for netzero technologies remains limited. Netzero technologies are seen as fundamental to attaining the EU's 2030 and 2050 climate and energy objectives (¹⁸). The country has limited capacity to produce steel structures for wind turbines or components for solar photovoltaic installations and solar thermal industries. The country has a stronger track record in the production and export of grid technology components (see Annex 7). There is currently no dedicated industrial policy strategy nor regulatory framework for net-zero manufacturing.

 ⁽¹⁸⁾ See European Commission, Proposal for a regulation of the European Parliament and of the Council on establishing a framework of measures for strengthening Europe's net-zero technology products manufacturing ecosystem (Net-Zero Industry Act), 16 March 2023, available at <u>Net-Zero Industry Act -</u> <u>European Commission</u>.

SKILLS, QUALITY JOBS AND SOCIAL FAIRNESS

Latvia faces considerable labour market and social challenges, which also hinder its competitiveness. The ageing of the population is leading to a decline in the labour force. Labour and skills shortages continue to weigh on economic growth and slow down the transition to digital and green economy. Furthermore, both the workforce and the economy suffer from healthcare outcomes. Social poor protection remains weak, with a persistently high poverty and social exclusion risk, notably for older people. Strengthening access to quality social services and longterm care, as well as improving the quality of housing, are essential for ensuring social fairness. Strong discrepancies in labour outcomes and wages between Riga and the regions negatively impact the regions' ability to attract and retain talent and families, exacerbating sociovouna economic and demographic challenges.

Addressing labour and skills shortages

Labour and skills shortages remain a significant challenge, in particular for the green and digital transitions. The Latvian labour market is facing labour and skills shortages, with high vacancy rates in kev sectors such construction, as manufacturing, insulation, forestry and healthcare. The share of science, technology, engineering and mathematics (STEM) graduates remains below the EU average (see Section 2), and only one in three STEM graduates is female, despite women's above-average tertiary education

attainment overall. The relatively low and decreasing level of digital competency also poses a significant risk to productivity: the proportion of individuals with basic or above-basic digital skills fell to 45.3% in 2023 and remains below the EU average of 55.6%. Improving digital literacy and 'green competencies' thus remains crucial to address labour and skills shortages.

Despite reform efforts, reskilling and upskilling are insufficient to provide the required talent and to meet national targets. In line with its recovery and resilience Latvia will undertake plan, significant establish reforms to а sustainable and socially responsible adult learning framework and improve digital skills in businesses and society. This includes regulation to improve access to upskilling and reskilling by creating more opportunities and incentives for employees to participate in education and training. Nevertheless, at 34.1% in 2022, the proportion of adults in education and training in the last 12 months remains well below the national target of 60% by 2030 and has been in decline since 2016. Furthermore, spending on active labour market policies remains low, with limited participation in training and activation measures among those seeking employment. While recent reforms in vocational education have made vocational education and training more flexible and attractive, continued efforts are needed to expand work-based learning as a way of making graduates more employable and supporting Latvia's competitiveness and productivity. Aligning workforce skills through reskilling and upskilling initiatives in collaboration with social partners remains crucial (see Annex 12).

Regional disparities in access to quality education continue to hamper skills development. While the education system performs comparatively well overall, indicators such as the number of STEM graduates and the share of early leavers from education and training show marked differences between urban and rural areas. Larger urban schools are also outperforming smaller rural ones in basic skills proficiency (see Annex 12). Access to quality education depends somewhat on place of residence, the reflected in significant differences in school sizes, student numbers and the ability to attract and retain teachers.

This is compounded by persisting challenges in renewing the teaching workforce. 37.5% of the teaching workforce are older than 55 years and approaching retirement and teacher shortages are becoming apparent. Despite government efforts, teaching remains a relatively unattractive career option for young graduates due to salary and workload concerns. Retraining programmes for future teachers have proven successful and continue to attract new participants, but they are unlikely to be sufficient to replenish teaching the workforce. Continued efforts to streamline and consolidate the large and inefficient school network and attract and retain new teachers could help reduce geographical disparities and improve quality.

Strengthening social fairness

The social protection system fails to lift aconsiderableproportionofthepopulationoutofpovertyorsocialexclusion.Despitesomepositive

developments in recent years, the rate of people at risk of poverty or social exclusion remains well above the EU average and is the highest among the Baltic states. Income inequality is high (the income of the wealthiest 20% of the population was 6.28 times higher than that of the least affluent 20% in 2024, vs 4.66 times in the EU), while general government social protection spending remains among the lowest in the EU. The impact of social transfers (excluding pensions) on poverty reduction is the lowest in the Baltic states, falling to 21.5% in 2024 (vs 34.4% in the EU).

Ensuring adequate income support for older people remains a key challenge. Old-age poverty remains particularly high, with 42.9% of people over the age of 65 deemed at risk of poverty in 2024 (vs 19.4% in the EU). This contributes significantly to the above-EU- average general at risk of poverty or social exclusion rate. A gradual introduction of a base pension system could help improve pension adequacy and reduce old-age poverty (¹⁹). Developing a long-term strategy, which could include strengthening the occupational (secondpillar) pension base, would be another major step towards pension adequacy. Measures in this area would help Latvia reach its 2030 national target on poverty reduction.

Significant socio-economic disparities the exist across regions, affecting provision of social services. The unemployment rate, the risk of poverty or social exclusion and the level of early school leavers are all higher in rural areas than in more urbanised areas. For instance, 29.4% of the rural population are at risk of poverty or social exclusion, compared to

^{(&}lt;sup>19</sup>) With current policies, public pension spending is projected to decline by 1.7 pps of GDP in 2024-2070 (see Annex 1).

23.3% of those living in towns and suburbs and 19.3% in cities in 2024. The eastern border region of Latgale, which shares a long border with Russia and Belarus, faces particularly high levels of unemployment and poverty, as well as a more pronounced demographic decline than the rest of the country. As responsibility for providing social services lies predominantly with municipalities, the socio-economic differences and local budgets determine the level of support provided. In this respect, a reform on the provision of minimum services (²⁰) was adopted in early 2025; it will be important to implement it effectively, with adequate funding (see Annex 12).

The need for quality long-term care (LTC) is rising and requires attention. The number of people of retirement age requiring municipal LTC services is rising. At the same time, public spending on LTC and home care remains below the EU average and remains inadequate given demographic trends. Municipalities show limited interest in taking up projects to develop new services. Home care remains underdeveloped, although the share of the population in need of LTC and who use formal home care services is high. Latvia would benefit from full implementation of the actions outlined in the Latvian recovery and resilience plan to promote access to and development of LTC services for 2024-2029, including the creation of a new and sustainable LTC financing model. Investing in LTC could help create new jobs, relieve the care burden for family members and make it easier for them to work, thus enhancing competitiveness. The European Social Fund Plus will help with the multidisciplinary development of а palliative home care system and provide training for social service professionals.

Ensuring access to quality housing

The shortage of housing impacts labour and social inclusion. mobility The overcrowding rate remains among the highest in the EU, at 39.3% in 2024, and the share of the population without a bath or shower in their dwelling is the second highest in the EU (9% in 2020). The existing housing stock is of poor quality, and the supply of affordable new housing is limited. While above the EU average, housing affordability deteriorated significantly from 2022 to 2023, in line with high inflation in that period. The shortage of quality primarily explained housing is bv historically low investment in housing, stemming from high levels of private ownership combined with low levels of wealth in the middle class. The stock of social housing and municipal low-rent housing is also low, with recurring reports of quality issues. In addition, a strategy to combat homelessness would lead to better inclusion and improve the chances of finding work for one of the most vulnerable groups in society (see Annex 11).

The need for investment in housing is high. With the support of the Recovery and Resilience Facility, Latvia has launched an affordable housing fund. for the construction of at least 467 low-rent apartments by 2026. The country has also invested significant amounts in support programmes to improve energy efficiency under the cohesion funds and the Recovery and Resilience Facility. Nevertheless, further investment is needed to raise the quality of housing, given the magnitude of the challenge. This would reduce the financial pressure on households from rising energy costs and the need for refurbishing and maintenance.

^{(&}lt;sup>20</sup>) Called the 'minimum services basket'.

Investing in a healthier population

Latvia faces significant challenges in improving the health of its population, with low life expectancy, high mortality rates and wide health inequalities posing a major concern. People in Latvia tend to have shorter and less healthy lives compared to other EU countries. This results in a significant loss of productive years, hindering the country's economic growth. The rate of preventable mortality is among the highest in the EU, linked to a high prevalence of behavioural risk factors. Furthermore, the proportion of the population reporting unmet medical needs is increasing, with 8.4% of the population affected in 2024, up from 7.8% in 2023 compared to an EU average of 2.4% in 2023. Lower-income households are disproportionately affected, underscoring inequality in access to health services (see Annex 14).

The health system is hindered by insufficient financing, limiting the adequacy of healthcare services. Latvia allocates one of the lowest percentages of GDP to healthcare in the EU (4.9% vs 8.4% in the EU in 2022). Out-of-pocket payments account for a greater proportion of health spending than the average across the EU, and this is related to the limited scope of the state-funded healthcare benefits package. Moreover, according to Ministry of Health data on January 2025, government spending on healthcare is set to decrease from 5% of GDP in 2024 to 4.8% in 2025, falling short of the national commitment to allocate 6% of GDP to healthcare by 2027. The government has proposed a draft law to reform the financing for healthcare by revising eligibility for access to publicly funded healthcare services and improving financial management through the establishment of a National Health Insurance Fund. However, the proposed law stops short of committing higher allocations of GDP to healthcare.

The persistent shortage of health professionals is an obstacle to providing adequate healthcare. Latvia has fewer doctors and nurses per 1 000 inhabitants than the EU average. The Ministry of Health has estimated that the health sector currently requires around 4 900 additional nurses (see Annex 14). Poor working conditions and low pay are deterrents to both entering and remaining in the public healthcare sector, particularly for nurses. The ageing of medical practitioners and their uneven regional distribution pose further challenges for the sector. As part of Latvia's recovery and resilience plan, in 2024, the government adopted a strategy for human resources in healthcare for 2025-2029. The strategy aims to improve recruitment and retention of health professionals by addressing key areas such as health workforce planning and financing, education and employment, as well as working conditions and performance. Investment from the European Social Fund Plus will be directed towards attracting and training medical staff.

Enhancing labour tax competitiveness

The recently adopted tax reform is expected to increase disposable income, narrow the tax wedge (²¹) and reduce

^{(&}lt;sup>21</sup>) In 2023, the labour tax wedge (tax and social contributions relative to labour cost) for single person earning less than the average wage was higher than in other Baltic countries and the EU average. This indicates that the labour tax system in Latvia is less progressive than in the EU on average and may incentivise low earners not to declare their (full) income.

poverty. A major part of the 2025 tax reform involves adjustments to the personal income tax system aimed at simplifying taxation and raising disposable income for most workers. A tax-benefit simulation with EUROMOD (²²) shows that the personal income tax reform is expected to: (i) increase disposable income for most households and especially middle-income earners; (ii) reduce the risk of poverty, particularly for older people, which is the most exposed group to poverty in Latvia; (iii) have a limited impact on income inequality as the lowest income groups are better supported through social transfers; and (iv) help reduce the labour tax wedge both for low-income earners and those earning the average wage and above.

Graph 4.1: Average personal income tax rates and income distribution, %



Source: European Commission, Joint Research Centre, based on the EUROMOD model, J0.1+.

While the immediate fiscal impact of the personal income tax reform is projected to be negative, the reform has some potential to improve labour market participation. The higher personal income tax rates, the new personal income tax brackets and the non-taxable allowance for all employees are expected to result in a substantial net negative fiscal impact. This has been partly financed by a temporary shift of pension contributions between pension pillars. At the same time, as the reform is estimated to lower the average personal income tax rate (personal income tax divided by earnings) for middle-income earners (see Graph 4.1), it could encourage low-income workers to transition into medium-income jobs as well as reduce the incentive for employers to underreport salaries.

^{(&}lt;sup>22</sup>) Estimations performed by the European Commission, Joint Research Centre, based on the EUROMOD model, Jo.1+.

KEY FINDINGS

To foster competitiveness, sustainability and social fairness, Latvia could benefit from:

- accelerating the implementation of the recovery and resilience plan, including the REPowerEU chapter; swiftly implementing cohesion policy, taking advantage of the opportunities under the mid-term review and making optimal use of EU instruments, including InvestEU and STEP, to improve competitiveness;
- **broadening taxation** to sources less detrimental to economic growth;
- improving public spending reviews by redirecting expenditure savings to priority areas, such as defence, healthcare and social protection;
- facilitating private investment in research and innovation, including by pursuing further reforms in higher education to strengthen cooperation between businesses and academia;
- improving access to finance for small and medium-sized enterprises, especially for scaling-up and commercialisation of innovations;
- reducing the administrative burden and simplifying regulations to remove barriers to investment in sectors like real estate;
- continuing to improve tax compliance and moving informal or undeclared activities into the formal economy;

- strengthening the societal and economic resilience of the regions, paying particular attention to Latvia's eastern borders;
- accelerating the deployment of wind and solar energy by improving permitgranting procedures and implementing smart grid queue management solutions;
- upgrading the electricity grid, promoting energy storage, demand response and market-based flexibility solutions;
- further decarbonising the road transport sector, by promoting the uptake of electric vehicles in public and private fleets and the production and distribution of renewable transport fuels, and by expanding recharging infrastructure;
- stepping up efforts for sustainable land management and use, especially by promoting a transition to more sustainable practices in the agricultural, forestry and peat extraction sectors;
- supporting the transition to a circular economy and improving waste management policies;
- addressing labour and skills shortages, particularly in STEM, research as well as the green and digital transitions, including through targeted upskilling and reskilling;
- **improving social outcomes** by increasing the adequacy of social

transfers and of old-age pensions, and by improving access to quality social services, especially home care;

- addressing the housing shortage, by increasing the availability and quality of social and affordable energy-efficient housing, including through renovations;
- **improving health outcomes** by broadening the statutory benefits package and reducing out-of-pocket payments.



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This Annex contains a series of tables relevant for the assessment of the fiscal situation in Latvia, including how Latvia is responding to Council recommendations issued under the reformed Economic Governance Framework.

The reformed framework, which entered into force on 30 April 2024(²³), aims to strengthen debt sustainability and promote sustainable and inclusive growth through growth-enhancing reforms and priority investments. The medium-term fiscal-structural plans (hereinafter, MTPs or plans) constitute the cornerstone of the framework, setting the budgetary commitment of Member States over the medium term. The latter is defined in terms of net expenditure growth, which is the single operational indicator for fiscal surveillance.

Latvia submitted its plan on 15 October 2024. The plan covers the period until 2028, presenting a fiscal adjustment over four years. On 21 January 2025, the Council adopted the Recommendation endorsing Latvia's plan(²⁴).

The assessment of the implementation of the Council Recommendation endorsing Latvia's plan is carried out on the basis of outturn data from Eurostat and the Commission's Spring 2025 Forecast and taking into account the Annual Progress Report (APR), that Latvia submitted on 29 April 2025. Furthermore, given Latvia's request to activate the National Escape Clause (NEC)(²⁵) in accordance with the Commission Communication of 19 March 2025(²⁶), the assessment also considers, as appropriate, the projected increase in defence expenditure based on the Commission Spring 2025 Forecast.

The Annex is organised as follows. First, developments in **government deficit and debt** are presented based on the figures reported in Table A1.1. Then, the assessment of the **implementation of the Council Recommendation endorsing the plan** follows, based on the relevant figures presented in Tables A1.2 to A1.9, including data on defence expenditure. The Annex also provides information on the **cost of ageing** and the **national fiscal framework**. Fiscal sustainability risks are discussed in the Debt Sustainability Monitor 2024.⁽²⁷⁾

⁽²³⁾ Regulation (EU) 2024/1263 of the European Parliament and of the Council (EU) on the effective coordination of economic policies and on multilateral budgetary surveillance, together with the amended Regulation (EC) No 1467/97 on the implementation of the excessive deficit procedure, and the amended Council Directive 2011/85/EU on the budgetary frameworks of Member States are the core elements of the reformed EU economic governance framework.

⁽²⁴⁾ OJ C, C/2025/652, 10.02.2025, ELI: <u>http://data.europa.eu/eli/C/2025/652/oj</u>

^{(&}lt;sup>25</sup>) On 28 April 2025, Latvia requested to the Commission and to the Council the activation of the National Escape Clause. On this basis, the Commission adopted a Recommendation for a Council Recommendation allowing Latvia to deviate from, and exceed, the net expenditure path set by the Council, COM(2025)610.

^{(&}lt;sup>26</sup>) Communication from the Commission accommodating increased defence expenditure within the Stability and Growth Pact of 19 March 2025, C(2025) 2000 final.

⁽²⁷⁾ European Commission (2025) 'Debt Sustainability Monitor 2024,' European Economy-Institutional Papers 306.

Developments in government deficit and debt

Latvia's government deficit amounted to 1.8% of GDP in 2024. Based on the Commission's Spring 2025 Forecast, it is projected to increase to 3.1% in 2025. The government debt-to-GDP ratio amounted to 46.8% of GDP at the end of 2024 and, according to the Commission, it is projected to increase to 48.6% end-2025. The increase in the debt ratio mainly reflects stock-flow adjustments and the projected primary deficit.

Table A1.1: General government balance and debt

	Variables		2024	2025		2026	
			Outturn	APR	COM	APR	COM
1	General government balance	%GDP	-1,8	-3,1	-3,1	n.a.	-3,1
2	General government gross debt	% GDP	46,8	49,0	48,6	n.a.	49,3

Source: Commission Spring 2025 Forecast (COM), Annual Progress Report (APR)

Developments in net expenditure

The net expenditure(²⁸) growth of Latvia in 2025 is forecast by the Commission(²⁹) to be within the recommended maximum. Considering 2024 and 2025 together, the cumulative growth rate of net expenditure is also projected within the recommended maximum cumulative growth rate.

	Annual			Cumulative*						
	REC	APR	COM	REC	APR	COM				
		Growth rates								
2024	n.a.	3.9%	4.5%	n.a.	n.a.	n.a.				
2025	5.9%	5.7%	5.7%	15.5%	9.8%	10.4%				
2026	3.6%	n.a.	4.4%	19.7%	n.a.	15.2%				

Table A1.2: Net expenditure growth

* The cumulative growth rates are calculated by reference to the base year of 2023. **Source:** Council Recommendation endorsing the national medium-term fiscal-structural plan of Latvia (Rec.), Annual Progress Report (APR) and Commission's calculation based on Commission Spring 2025 Forecast (COM).

General government defence expenditure in Latvia amounted to 2.5% of GDP in 2021, 2.4% of GDP in 2022 and 3.1% of GDP in 2023 (³⁰). According to the Commission 2025 Spring Forecast, expenditure on defence is projected to amount to 3.0 % of GDP in 2024 and 3.3% of GDP in 2025.

⁽²⁸⁾ Net expenditure is defined in Article 2(2) of Regulation (EU) 2024/1263 as government expenditure net of (i) interest expenditure, (ii) discretionary revenue measures, (iii) expenditure on programmes of the Union fully matched by revenue from Union funds, (iv) national expenditure on co-financing of programmes funded by the Union, (v) cyclical elements of unemployment benefit expenditure, and (vi) one-off and other temporary measures.

⁽²⁹⁾ Commission Spring 2025 Forecast, European Economy-Institutional paper 318, May 2025.].

^(3°) Eurostat, government expenditure by classification of functions of government (COFOG).

Table A1.3: Net expenditure (outturn and forecast), annual and cumulated deviations vis-à-vis the recommendation

	Variables		2023	2024	2025	2026
	variables		Outturn	Outturn	COM	COM
1	Total expenditure	bn NAC	172	18.4	20.0	20.9
2	Interest expenditure	bn NAC	0.3	0.4	0.5	0.6
3	Cyclical unemployment expenditure	bn NAC	0.0	0.0	0.0	0.0
4	Expenditure funded by transfers from the EU	bn NAC	0.7	0.8	1.3	1.4
5	National co-financing of EU programmes	bn NAC	02	0.1	0.2	02
6	One-off expenditure (levels, exd. EU funded)	bn NAC	0.0	0.0	0.0	0.0
7-4.0.0.4.5.0	Net nationally financed primary expenditure (before		46.0	47.0	40.0	49.6
/=1-2-3-4-5-6	discretionary revenue measures, DRM)	DITNAC	10.0	17.0	10.0	10.0
8	Change in net nationally financed primary expenditure (before DRM)	bn NAC		1.0	1.0	0.7
9	DRM (exd. one-off revenue, incremental impact)	bn NAC		0.3	0.0	-0.1
40-9.0	Change in net nationally financed primary expenditure			07	10	0.0
10-0-9	(after DRM)	DITINAL		0.7	1.0	0.0
11	Outturn / forecast net expenditure growth	% change		4.47%	5.7%	4.4%
12	Recommended net expenditure growth*	% change		9.1%	5.9%	3.6%
13=(11-12) x 7	Annual deviation	bn NAC		-0.7	0.0	0.1
14 (cumulated from 13)	Cumulated deviation	bn NAC		-0.7	-0.8	-0.6
15=13/17	Annual balance	% GDP		-1.8	-0.1	0.3
16=14/17	Cumulated balance	% GDP		-1.8	-1.9	-1.4
17	p.m. Nominal GDP	bn NAC	39.4	40.2	42.0	44.0

* The growth rate for 2024 is not a recommendation but serves to anchor the base, as the latest year with outturn data when setting the net expenditure path is year 2023.

Source: Commission Spring 2025 Forecast and Commission's calculation.

Table A1.4: Defence expenditure and the national escape clause

			2021	2022	2023	2024	2025	2026
1	Total defence expenditure	%CDP	2,5	2,4	3,1	3,0	3,3	3,8
2	of which: gross fixed capital formation	%CDP	1,0	0,2	0,5	0,8	1,0	1,5
3	Rexibility from increases in defence expenditure	%CDP					0,8	1,3
4	Cumulated balance after flexibility	% GDP					-2,7	-2,8

Source: Eurostat (COFOG), Commission Spring 2025 Forecast and Commission's calculation

	Variables		2024	20	25	20	26
	Variables		Outturn	APR	COM	APR	COM
1=7+8+9	Real GDP	% change	-0,4	1,2	0,5	n.a.	2,0
2	Private consumption	% change	0,5	1,3	1,0	n.a.	1,9
3	Government consumption expenditure	% change	7,6	4,6	1,7	n.a.	1,5
4	Gross fixed capital formation	% change	-6,7	0,8	-1,2	n.a.	2,6
5	Exports of goods and services	% change	-1,6	1,7	1,8	n.a.	2,0
6	Imports of goods and services	% change	-2,3	2,8	2,1	n.a.	2,1
	Contributions to real GDP growth						
7	- Final domestic demand	pps	0,2	2,6	0,7	n.a.	2,0
8	- Change in inventories	pps	-1,2	-0,6	0,0	n.a.	0,0
9	- Net exports	pps	0,6	-0,8	-0,2	n.a.	-0,1
10	Output gap	%pot @P	-0,5	-1,5	-1,3	n.a.	-0,7
11	Employment	% change	-0,9	-0,1	-0,4	n.a.	-0,4
12	Uhemployment rate	%	6,9	6,7	6,8	n.a.	6,6
13	Labour productivity	% change	0,5	1,3	0,9	n.a.	2,4
14	НФ	% change	1,3	2,5	3,0	n.a.	1,7
15	GDP deflator	% change	2,6	3,1	3,9	n.a.	2,8
16	Compensation of employees per head	% change	9,1	5,8	5,5	n.a.	4,5
17	Net lending/borrowing vis-à-vis the rest of the world	%@P	-1,7	n.a.	-1,9	n.a.	-1,4

Table A1.5: Macroeconomic developments and forecasts

Source: Commission Spring 2025 Forecast (COM), Annual Progress Report (APR)

Table A1.6: General government budgetary position

	Variables (%, CDP)	2024	20	25	20	26	
		Outturn	APR	COM	APR	COM	
1=2+3+4+5	Revenue	43,9	43,9	44,4	n.a.	44,4	
	of which:						
2	- Taxes on production and imports	14,5	14,8	14,6	n.a.	14,8	
3	- Current taxes on income, wealth, etc.	9,3	8,7	8,6	n.a.	8,6	
4	- Social contributions	11,6	12,1	11,9	n.a.	11,9	
5	- Other (residual)	8,5	8,3	9,3	n.a.	9,1	
8=9+16	Expenditure	45,7	47,1	47,6	n.a.	47,5	
	of which:						
9	- Rimary expenditure	44,6	45,8	46,3	n.a.	46,1	
	of which:						
10	- Compensation of employees	13,2	13,2	13,4	n.a.	13,3	
11	- Intermediate consumption	6,4	6,8	6,4	n.a.	6,4	
12	- Social payments	15,1	14,6	15,2	n.a.	15,3	
13	- Subsidies	0,7	0,9	0,7	n.a.	0,7	
14	- Gross fixed capital formation	5,7	6,0	7,0	n.a.	7,2	
15	- Other	3,5	4,3	3,4	n.a.	3,1	
16	- Interest expenditure	1,1	1,3	1,3	n.a.	1,4	
18=1-8	General government balance	-1,8	-3,1	-3,1	n.a.	-3,1	
19=1-9	Primary balance	-0,7	-1,8	-1,8	n.a.	-1,7	
20	Cydically adjusted balance	-1,6	n.a.	-2,6	n.a.	-2,9	
21	One-offs	0,0	0,0	0,0	n.a.	0,0	
22=20-21	Structural balance	-1,6	-2,6	-2,6	n.a.	-2,9	
23=22+16	Structural primary balance	-0,5	-1,2	-1,3	n.a.	-1,4	

Source: Commission Spring 2025 Forecast (COM), Annual Progress Report (APR)

Table A1.7: Debt developments

	Veriables	2024	20	25	2026		
	Variables	Outturn	APR	COM	APR	COM	
1	Gross debt ratio* (% of GDP)	46.8	49.0	48.6	n.a.	49.3	
2=3+4+8	Change in the ratio (pps. of GDP)	2.1	2.3	1.9	n.a.	0.6	
	Contributions**						
3	Primary balance	0.7	1.8	1.8	n.a.	1.7	
4≈5+6+7	'Snow-ball' effect	0.2	-0.6	-0.7	n.a.	-0.8	
	of which:						
5	- Interest expenditure	1.1	1.3	1.3	n.a.	1.4	
6	- Real growth effect	0.2	-0.5	-02	n.a.	-0.9	
7	- Inflation effect	-1.1	-1.4	-1.8	n.a.	-1.3	
8	'Stock-flow' adjustment	1.3	1.1	0.7	n.a.	-0.3	

* End of period.

** The 'snow-ball' effect captures the impact of interest expenditure on accumulated general government debt, as well as the impact of real GDP growth and inflation on the general government debt-to-GDP ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting (including leads and lags in Recovery and Resilience Facility grant disbursements), accumulation of financial assets, and valuation and other residual effects. **Source:** Commission Spring 2025 Forecast and Commission's calculation (COM), Annual Progress Report (APR)

Table A1.8	: RRF – Grants							
	Revenue from RRF grants (% of GDP)							
		2020	2021	2022	2023	2024	2025	2026
1	RRF grants as included in the revenue projections	n.a.	0,0	0,0	0,4	0,9	1,8	1,5
2	Cash disbursements of RRF grants from EU	n.a.	0,7	0,6	0,0	0,9	0,7	2,0

	Expenditure financed by RRF grants (% of GDP)							
		2020	2021	2022	2023	2024	2025	2026
3	Total current expenditure	0,0	0,0	0,0	0,1	0,3	0,6	0,6
4	Gross fixed capital formation	0,0	0,0	0,0	0,3	0,6	1,2	1,0
5	Capital transfers	0,0	0,0	0,0	0,0	0,0	0,0	0,0
6=4+5	Total capital expenditure	0,0	0,0	0,0	0,3	0,6	1,2	1,0

	Other costs financed by RRF grants (% of GDP)							
		2020	2021	2022	2023	2024	2025	2026
7	Reduction in tax revenue	0,0	0,0	0,0	0,0	0,0	0,0	0,0
8	Other costs with impact on revenue	0,0	0,0	0,0	0,0	0,0	0,0	0,0
9	Financial transactions	0,0	0,0	0,0	0,0	0,0	0,0	0,0

Source: Annual Progress Report

Table A1.9: **RRF - Loans**

	Cash flow from RRF loans projected in the Plan (% of GDP)							
		2020	2021	2022	2023	2024	2025	2026
1	Disbursements of RRF loans from EU	n.a.	0,0	0,0	0,0	0,0	0,0	0,0
2	Repayments of RRF loans to EU	n.a.	0,0	0,0	0,0	0,0	0,0	0,0

	Expenditure financed by RRF loans (% of GDP)							
		2020	2021	2022	2023	2024	2025	2026
3	Total current expenditure	0,0	0,0	0,0	0,0	0,0	0,0	0,0
4	Gross fixed capital formation	0,0	0,0	0,0	0,0	0,0	0,0	0,0
5	Capital transfers	0,0	0,0	0,0	0,0	0,0	0,0	0,0
6=4+5	Total capital expenditure	0,0	0,0	0,0	0,0	0,0	0,0	0,0

	Other costs financed by RRF loans (% of GDP)							
		2020	2021	2022	2023	2024	2025	2026
7	Reduction in tax revenue	0,0	0,0	0,0	0,0	0,0	0,0	0,0
8	Other costs with impact on revenue	0,0	0,0	0,0	0,0	0,0	0,0	0,0
9	Financial transactions	0,0	0,0	0,0	0,0	0,0	0,0	0,0
-								

Source: Annual Progress Report

Cost of ageing

Total age-related spending in Latvia is projected to decrease from about 16% of GDP in 2024 to around 15% by 2070 (see Table A1.10). The overall decrease by 2070 is driven by pension and, to a lesser extent, education spending, which together more than offset the expected increase in healthcare and long-term care spending. The pension expenditure-to-GDP ratio would fall by 1.7 pps, of which 0.6 pps by 2040, from 7.1% of GDP in 2024 to 5.4% in 2070, the lowest projected level of all Member States. At 15.4% of GDP in 2070, Latvia would be spending the least of all Member States on age-related items.

Public healthcare (³¹) expenditure is projected at 5.3% of GDP in 2024 (below the EU average of 6.6%) and is expected to increase by 0.4 pps by 2040 and by a further 0.1 pp by 2070.

Public expenditure on long-term care $(^{32})$ is projected at 0.5% of GDP in 2024 (below the EU average of 1.7%) and is expected to increase by 0.1 pp of GDP by 2040 and by a further 0.2 pps of GDP by 2070.

⁽³¹⁾ Key performance characteristics, recent reforms and investments are discussed in Annex 11 'Health and health systems'.

⁽³²⁾ The quality and the accessibility of the long-term care system are covered in Annex 9 'Social policies'.
	age-related	age-related change in 2024- <u>2040</u> (pps GDP) due to:				age-related							
	2024 (% GDP)	pensio	ons	healthc	are	long-term	care	educa	tion	total		2040 (%GDP)	
LV	16.4		-0.6		0.4	1 - E	0.1		-0.3		-0.4	16.0	LV
EU	24.3		0.5		0.3	—	0.4		-0.3		0.9	25.2	EU
	age-related change in 2024- <u>2070</u> (pps GDP) due to:											age-related	
	2024 (% GDP)	pensio	ons	healthc	are	long-term	care	educa	tion	total		_2070 (%GDP)	_
	16.4		-1.7		0.5		0.3	-	-0.3		-1.1	15.4	LV
LV	10.4												

Table A1.10: Projected change in age-related expenditure in 2024-2040 and 2024-2070

National fiscal framework

The Latvian Fiscal Discipline Council (FDC) is a relatively small independent fiscal institution with a rather narrow mandate. It serves as endorser of macroeconomic forecasts and monitors compliance with fiscal rules. It is not involved in any budgetary forecast assessments but does some work on long-term fiscal projections. With only three full-time staff, the FDC reports a need for more resources. Its autonomy could be enhanced by allowing it to reallocate funds between expenditure types (for example wages for services), which would put it on a similar level as other Latvian independent institutions, such as the Audit office. The FDC appears regularly in mainstream national TV/radio/daily papers throughout the year and has an explicit communication strategy.

Table A1.11: Fiscal Governance Database Indicators		
2023	Latvia	EU Average
Country Fiscal Rule Strength Index (CFRSI)	12.58	14.52
Medium-Term Budgetary Framework Index (MTBR)	0.78	0.73

The Country Fiscal Rule Strength Index (C-FRSI) shows the strength of national fiscal rules aggregated at the country level based on i) the legal base, ii) how binding the rule is, iii) monitoring bodies, iv) correction mechanisms, and v) resilience to shocks. The Medium-Term Budgetary Framework Index (MTBFI) shows the strength of the national MTBF based on i) coverage of the targets/ceilings included in the national medium-term fiscal plans; ii) connectedness between these targets/ceilings and the annual budgets; iii) involvement of the national parliament in the preparation of the plans; iv) involvement of independent fiscal institutions in their preparation; and v) their level of detail. A higher score is associated with higher rule and MTBF strength.

Source: Fiscal Governance Database

ANNEX 2: TAXATION

This annex provides an indicator-based overview of Latvia's tax system. It includes information on: (i) the tax mix; (ii) competitiveness and fairness aspects of the tax system; and (iii) tax collection and compliance.

Latvia's tax revenues remain relatively low in relation to its GDP. Table A2.1 shows that Latvia's tax revenues were still below the EU average in 2023 (equivalent to about 32.7% of GDP compared with 39% for the EU). In 2023, tax revenues from labour taxation were equivalent to 16.4% of GDP (below the EU average of 20%), while revenues from consumption taxes were equivalent to 13.5% of GDP (higher than the EU average of 10.5%). In 2023, revenues from property taxes were equivalent to 0.8% of GDP, significantly higher than in Baltic peers Lithuania (0.4%) and Estonia (0.3%), but far below the EU average of 1.9%.



In 2024, Latvia's labour tax burden was higher than the EU average for low earners. The labour tax wedge (³³) for Latvia in 2024 exceeded the EU average for single people earning the average wage or less. For instance,

it was 35% for single workers earning 50% of the average wage, as compared to 31.8% in the EU average. The tax wedge at higher earnings levels increased in 2024, but still it was slightly below the EU average. This means that labour taxation in Latvia is somewhat less progressive than in the EU on average. This is also reflected in the relatively low effect of taxes and social transfers on inequality. These programs reduced the Gini index of income inequality by 5.5 points in Latvia as compared to 7.7 points in the EU average (Table A2.1). Latvia's 2025 tax reform provides for significant changes in personal-income taxation. Latvia's 2025 tax reform introduced: (i) two progressive income-tax rates (25.5% for annual earnings up to EUR 105 300 and 33% for incomes greater than this); (ii) an additional tax of 3% on total income exceeding EUR 200 000 per year; (iii) an increase in the non-taxable amounts of monthly income for employed and retired persons (the tax-free allowance); and (iv) an increased tax rate of 25.5% on capital gains. In addition, the 2025 tax reform provides for: (i) an increase in gambling taxes, excise taxes and taxes on vehicles; (ii) a decreased VAT rate for fresh fruits and vegetables; (iii) an exemption from VAT for certain medical services; and (iv) the introduction of a temporary solidarity levy on credit institutions for the years 2025-2027. The costs of the personal-income-tax reform will be also partially compensated by shifting one percentage point of tax from the second to the first 'pillar' of the pension system from 2025 until 2028 (i.e. reducing tax on the second pillar by one percentage point and increasing tax on the first pillar by one percentage point).

⁽³³⁾ The tax wedge is defined as the sum of personal income taxes and employee and employer social-security contributions net of family allowances, expressed as a percentage of total labour costs (the sum of the gross wage and social-security contributions paid by the employer).

Table A2.1: Taxation indicators

		Latvia				EU-27					
		2010	2021	2022	2023	2024	2010	2021	2022	2023	2024
Tax structure	Total taxes (including compulsory actual social contributions) (% of GDP) $% \left(\left(\mathcal{A}^{(1)}_{\mathcal{A}}\right) \right) =\left(\left(\left(\left(\left(\mathcal{A}^{(1)}_{\mathcal{A}}\right) \right) \right) \right) \right)$	28.9	32.0	32.8	32.7		37.8	40.2	39.7	39.0	
	Taxes on labour (% of GDP)	14.6	15.5	15.7	16.4		19.8	20.5	20.1	20.0	
	of which, social security contributions (SSC, % of GDP)	8.8	9.9	10.0	10.4		12.9	13.0	12.7	12.7	
By tax base	Taxes on consumption (% of GDP)	11.5	13.6	14.2	13.5		10.9	11.2	10.9	10.5	
	of which, value added taxes (VAT, % of GDP)	6.8	9.0	10.1	9.7		6.8	7.3	7.4	7.1	
	Taxes on capital (% of GDP)	2.8	2.9	2.9	3.1		7.1	8.5	8.7	8.5	
	Personal income taxes (PIT, % of GDP)	6.3	6.2	6.3	6.5		8.6	9.6	9.4	9.3	
	Corporate income taxes (CIT, % of GDP)	1.0	1.1	1.1	1.4		2.2	2.9	3.2	3.2	
Some tax types	Total property taxes (% of GDP)	1.0	1.0	0.9	0.8		1.9	2.2	2.1	1.9	
Some tax types	Recurrent taxes on immovable property (% of GDP)	0.7	0.7	0.6	0.6		1.1	1.1	1.0	0.9	
	Environmental taxes (% of GDP)	3.0	3.0	2.4	2.4		2.5	2.4	2.1	2.0	
	Effective carbon rate in EUR per tonne of OO_2 equivalents	NA	73.8	NA	62.2		NA	86.0	NA	84.8	
	Tax wedge at 50% of average wage (single person) (*)	42.4	35.3	33.5	33.7	35.0	33.9	31.8	31.5	31.5	31.8
	Tax wedge at 100% of average wage (single person) (*)	44.0	40.5	40.4	41.0	41.7	40.9	39.9	39.9	40.2	40.3
Progressivity &	Corporate income tax - effective average tax rates (1) (*)	11.9	16.5	16.5	16.5		21.3	19.3	19.1	18.9	
Tairness	Difference in Gni coefficient before and after taxes and cash social transfers (pensions excluded from social transfers) (2) (*)	5.8	5.5	5.5	5.5		8.6	8.2	7.9	7.7	
Tax administration &	Outstanding tax arrears: total year-end tax debt (including debt considered not collectable) / total revenue (in %) (*)		9.9	7.0				35.5	32.6		
compliance	VAT gap (% of VAT total tax liability, VTTL) (**)		10.2	5.1	8.9			6.6	7.0		

(1) Forward-looking effective tax rate (KPMG).

(2) A higher value indicates a stronger redistributive impact of taxation.

(*) EU-27 simple average.

(**) Forecast value for 2023. For more details on the VAT gap, see European Commission, Directorate-General for Taxation and Customs Union, VAT gap in the EU - 2024 report, <u>https://data.europa.eu/doi/10.2778/2476549</u> For more data on tax revenues as well as the methodology applied, see the Data on Taxation webpage, <u>https://ec.europa.eu/taxation_customs/taxation-1/economic-analysis-taxation/data-taxation_en</u>. *Source:* European Commission, OECD

Graph A2.2: Tax wedge for single and second earners, % of total labour costs, 2024



The tax wedge for second earners assumes a first earner at 100% of the average wage and no children. For the full methodology, see OECD, 2016, Taxing Wages 2014-2015. *Source:* European Commission Rankings (³⁴) due to the strengths of Latvia's corporate-income-tax system, which only taxes distributed earnings, allowing companies to reinvest their profits tax-free.

The size of Latvia's shadow economy is decreasing. Surveys of company owners and managers indicate that Latvia's shadow economy was equivalent to 22.9% of its GDP in 2023 (a decrease from 26.5% in 2022). The biggest component of the shadow economy is the underreporting of salaries (estimated to account for 48.2% of Latvia's shadow economy), with an average of 23.6% of total salaries being paid informally ('envelope wages'). The construction (34.2%) and retail (27%) sectors had the highest estimated shares of shadow activity in 2023 (³⁵).

Latvia's business-taxation system is attractive for foreign investors. It ranked second in the Tax Foundation's 2024 International Tax Competitiveness Index

^{(&}lt;sup>34</sup>) Tax Foundation (2024): International Tax Competitiveness Index 2024.

⁽³⁵⁾ Stockholm School of Economics Riga, Shadow Economy Index for the Baltic Countries, <u>Shadow Economy Index for</u>

Latvia's VAT gap continues to decrease. In 2022, the VAT compliance gap was estimated at EUR 193 million or 5.0% of the VAT total tax liability (VTTL), a decrease of 5.2 percentage points compared with 2021. With an EU VAT compliance gap of approximately 7.0%, Latvia ranked 11th among the EU Member States in 2022. Between 2018 and 2022, Latvia's VAT compliance gap decreased from 13.3% to 5.0%. The actionable VAT policy gap (³⁶) was 11.5% in 2022 - a decrease of 1.0 percentage points compared with 2021. Between 2018 and 2022, the actionable VAT policy gap decreased from 15.5% to 11.5% (³⁷).

the Baltic Countries | Stockholm School of Economics in Riga.

- (36) The actionable VAT policy gap refers to the portion of the VAT policy gap that can be influenced by Member States. Specifically, it relates to the foregone VAT revenues that can be attributed to reduced rates and exemptions that could potentially be discontinued or eliminated.
- (37) <u>https://taxation-customs.ec.europa.eu/taxation/vat/fight-against-vat-fraud/vat-gap_en#paragraph_1530</u>

PRODUCTIVITY ANNEX 3: INNOVATION TO BUSINESS

Latvia is an 'emerging innovator' and its innovation performance increases relatively slowly. According to the 2024 edition of the European Innovation Scoreboard (³⁸), Latvia's innovation performance stands at only 53.6% of the EU average and has improved at a slower rate than the EU average over the last years. This is caused by a very low R&D intensity, which has stagnated at around 0.82% of GDP; this is about a third of the EU average (2.24%) and well behind that of the other Baltic countries (see Graph A3.1). Latvia has one of the lowest business expenditure on R&D (BERD) rates in the EU (0.30% of GDP). Moreover, the lack of highly skilled human capital is a major barrier to both the science base and business innovation, and private R&D is held back by the lack of access to finance and low government support for business R&D.



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Science and innovative ecosystems

The public research base in Latvia is weak overall, with only a few high-performing institutions. Latvia performs significantly below the EU average in terms of quality of research outputs. This is demonstrated by the percentage of its scientific publications within the top 10% most cited scientific publications worldwide, which is substantially below the EU average (4.55% in Latvia vs 9.64% in the EU in 2021)(³⁹). This is caused, among other things, by longstanding public underinvestment in R&D, which has stagnated since 2018 and stood at 0.53% in 2023, vs the EU average of 0.72% (⁴⁰). While both the Latvian recovery and resilience plan (RRP) and its cohesion positively policy can contribute to improving the research and innovation (R&I) ecosystem over the next years, the country needs to further increase public R&D spending to reach its own target $(^{41})$. In addition, the consolidation of universities creation of an innovation and the governance model, both part of the RRP, aim to address fragmentation and increase efficiency. While these are seen as positive steps, their impact remains to be seen and there is a need for continuous monitoring and evaluation going forward. Latvia could benefit from a long-term holistic vision for R&I and a centralised body to coordinate and monitor policy actions and investments. addition, Latvia consider In could

^{(38) 2024} European Innovation Scoreboard, Country profile, Latvia: <u>https://projects.research-andinnovation.ec.europa.eu/en/statistics/performanceindicators/european-innovation-scoreboard/eis-2024#/eis/countries/LV.</u> The EIS provides a comparative analysis of innovation performance in EU countries, including the relative strengths and weaknesses of their national innovation systems (also compared to the EU average).

⁽³⁹⁾ Based on fractional count in a 2-year citation window

⁽⁴⁰⁾ OECD Economic Surveys: Latvia 2022 https://doi.org/10.1787/co113448-en

⁽⁴¹⁾ Target of 1.5% of GDP is set for GERD in the National Development Plan of Latvia for 2021-2027: <u>https://www.pkc.gov.lv/sites/default/files/inline-files/NAP2027_ENG.pdf</u>.

strengthening performance-based funding for research performing institutions to foster excellence, internationalisation and translating research outputs into innovation (⁴²).

State support for research and innovation is fragmented. National R&I funding programmes are mostly managed by the Latvian Council of Science and the Latvian Investment and Development Agency, but other ministries are also involved in a small number of thematic R&I programmes. Cohesion policy funds, however, are managed by the Central Finance and Contracting Agency, which reports to the Ministry of Finance. This division led to a misalignment of funding calls depending on their source, undermined the development of a critical mass and reduced the quality of R&I outputs (43). The new innovation governance system, including the Innovation & Research Governance Council set up as part of the RRP, aims to address this fragmentation, but continuous assessment and finetuning should envisioned be to optimise coordination between funding sources. Better coordination and strategic planning could allow measures such as follow-on funding and plug-in schemes to be put in place in order to provide holistic support throughout the innovation life-cycle.

Business innovation

Latvia's innovation potential remains largely unexploited, with low output and productivity, and the economy dominated by low-tech sectors. Business R&D expenditure is critically low at 0.3% of GDP, significantly below the EU average of 1.49% in 2023; and unlike in other Member States it is also lower than public R&D expenditure. The high-tech sectors are limited, as many international firms conduct their R&D activities in other countries, and the low-tech sectors are dominant in Latvia, both of which contribute to the poor performance (44). All this is reflected in a very low innovation output in terms of patents and trademarks, with only 1.0 patent application per billion GDP compared to the EU average of 2.8 in 2022, and a low number of researchers employed by businesses (⁴⁵). Encouraging businesses to hire more researchers and fostering R&D activity could help Latvia strengthen hightech sectors, boost productivity and retain talent through the creation of attractive job opportunities. Latvia does not currently have any corporate R&D tax incentives in place, but uses mostly direct funding to support business innovation. However, the low level of business innovation in Latvia suggests that the current support is insufficient. Consideration could be given to increasing the volume of funding and introducing indirect funding, such as refundable tax credits, and to using public procurement to stimulate broader R&D activity businesses and improve in

^{(&}lt;sup>42</sup>) OECD Economic Surveys: Latvia 2022 https://doi.org/10.1787/c0113448-en

 ⁽⁴³⁾ European Commission (2018), Specific Support to Latvia: The Latvian Research Funding System <u>https://projects.research-and-</u> <u>innovation.ec.europa.eu/sites/default/files/rio/report/</u> <u>H2020%2520PSF_Specific%2520Support%2520Latvia</u> <u>a_Final%2520report.pdf</u>

⁽⁴⁴⁾ Added value in high-tech and medium-high-tech manufacturing accounts for only 3% (EU average: 6.8%), and low to medium-low tech manufacturing accounts for 87% of the total manufacturing labour force. Source: Eurostat.

⁽⁴⁵⁾ Researchers employed by businesses make up only 1.4 per thousand active population (EU average: 7.0).

monitoring (⁴⁶). Moreover, Latvia should use grants for business innovation strategically to encourage capacity building and future innovation activities, for example by demanding a financial contribution from private stakeholders or employing researchers.

Low basic digital intensity among Latvian SMEs hinders their ability to adopt technologies. advanced Despite improvements in the take-up of cloud computing and data analytics, Latvia lags behind in basic digital intensity for SMEs and advanced technologies such as AI (⁴⁷). Moreover, basic digital skills declined by 5% in 2023 (48). While some promising measures have been introduced under the RRP, such as the Digital Innovation Hubs (DIHs) and financial support for SME digitalisation (49), complemented by other EU programmes (⁵⁰), their scope may be insufficient to address existing gaps. More ambitious national initiatives are needed to achieve the EU Digital Decade targets (⁵¹). Higher uptake of these technologies could also help Latvia to transition towards high-

- (48) Digital Economy and Society Index <u>https://digital-decade-desi.digital-</u> <u>strategy.ec.europa.eu/datasets/desi/charts.</u>
- (49) Latvia aims to support 3 500 SMEs through DIHs by 2026.
- (5°) Latvia participates as an indirect partner in the IPCEI on Next Generation Cloud Infrastructure and Services.
- (51) The Digital Decade policy programme sets out a pathway for the EU's digital transformation, including concrete commitments from Member States to jointly achieve objectives (e.g. competitiveness, resilience, sovereignty) and digital targets by 2030.

tech sectors and increase its competitiveness.

Science-business linkages are improving, but continued support for applied and collaborative research is needed. The country has been performing relatively well on relevant indicators such as public-private scientific co-publications (⁵²) and contractual research (⁵³). However, science-business linkages in Latvia are hampered by an underdeveloped research base and low innovation activity in the private sector (54). The new Innovation Fund's industry research programme (⁵⁵) supporting applied science and commercial-oriented research, which was launched in 2024 and will run until 2032. could brina further improvements. Going forward, it will be systematically important to improve businesses collaboration between and research institutions. for instance by increasing private-sector representation in university councils (⁵⁶). Ties could be strengthened by incorporating financial incentives into university funding for commercialisation private-sector and collaboration. Other options to be considered include increasing researchers' share of patent royalties and highlighting private cooperation in the evaluations of

- (54) Innovation Diffusion in Latvia, OECD, 2021 <u>https://www.oecd.org/en/publications/innovation-</u> <u>diffusion-in-latvia_7d6doffc-en.html.</u>
- (55) <u>https://www.researchlatvia.gov.lv/en/long-term-</u> research-program-will-develop-least-45-<u>technologies-until-2032.</u>
- (56) OECD Economic Surveys: Latvia 2024 <u>https://www.oecd.org/en/publications/oecd-</u> <u>economic-surveys-latvia-2024_dfeae75b-en.html.</u>

⁽⁴⁶⁾ OECD Economic Surveys: Latvia 2022 https://www.oecd.org/en/publications/oecdeconomic-surveys-latvia-2022_co113448-en.html.

⁽⁴⁷⁾ Adoption of cloud computing stood at 29%, data analytics usage at 36.9%, basic digital intensity for SMEs at 48.2% and advanced technologies at 4.5% in 2023 (vs the EU averages of 38.9%, 33.2%, 57.5% and 8%, respectively).

^{(52) 8.6%} of total publications were public-private scientific co-publications in 2023. EU average: 7.7%.

⁽⁵³⁾ As indicated by public expenditure on R&D financed by business enterprises as a percentage of GDP.

universities and public research institutions (⁵⁷).

Financing innovation

Access to finance for innovation is still limited in Latvia. Despite efforts by the investments, government to increase Latvia's start-up ecosystem still faces a shortage of venture capital (with current levels about a fourth of the EU average $(^{58})$). Also, most investments are made at the earlier stages while funding at later stages is scarce, which is perceived as a barrier to scaling up innovation (⁵⁹). Encouragingly, the start-up ecosystem is becoming less reliant on government funding, with the proportion of government-sourced capital now comparable to that of the other Baltic countries (⁶⁰). The 2022-2025 start-up ecosystem development strategy (⁶¹) includes various activities to address the needs of start-ups, such as training, mentoring programmes and conferences. However, these initiatives have yet to bear fruit and could encounter barriers such as the lack of highly-skilled talent.

- (57) OECD Economic Surveys: Latvia 2022 https://www.oecd.org/en/publications/oecdeconomic-surveys-latvia-2022_co113448-en.html.
- (⁵⁸) LV average 0.019% of GDP in 2023 EU average is 0.078% of GDP.
- (59) Innovation Diffusion in Latvia, OECD, 2021 <u>https://www.oecd.org/en/publications/innovation-diffusion-in-latvia_7d6doffc-en.html.</u>
- (⁶⁰) From 2018 to 2023 government funding still accounted for 27% of capital raised; it was 20% in 2023.
 Source: KPMG, LTVC, LVCA, ESTVCA, Baltic Private Equity and Venture Capital Market Overview 2023 <u>https://www.balticpevcmarket.com/s/2024_KPMG_report_0514.pdf.</u>
- (⁶¹) Strategy for the development of the start-up ecosystem <u>https://www.em.gov.lv/lv/jaunuznemumu-</u> <u>ekosistemas-attistibas-strategija</u>.

Innovative talent

The lack of human capital is holding back skills research performance, and shortages are considered one of the main barriers to innovation in Latvia. The low number of researchers both in business and in the public sector (1.5 and 3.2 per thousand active population, respectively, vs the EU average of 5.7 and 4.2) limits Latvia's research and innovation capacity and could also negatively impact the R&I system's ability to absorb funds going forward (⁶²). The number of doctoral graduates (⁶³) and technology, engineering science, and mathematics (STEM) graduates (⁶⁴) is low, and the rate of increase, is insufficient to address the shortage of researchers in the short to medium term (⁶⁵). The new doctoral model, part of the RRP, has already increased the number of new doctoral students but the number of doctoral graduates is yet to grow, and the dropout rate is still high (see Graph A3.2). The effect of these measures on the workforce will therefore only become significant in the long term. Going forward, it will be necessary to continue to improve working conditions for researchers, increase the number of doctoral students and tenured positions, predictable and ensure

(⁶²) OECD Economic Surveys: Latvia <u>https://www.oecd-ilibrary.org/economics/oecd-</u> <u>economic-surveys-latvia_25222988</u>

- (⁶³) 3 254 doctoral students enrolled, 158 doctoral graduates and 822 new entrants in 2023 according to Latvia Statistical office <u>https://data.stat.gov.lv/pxweb/en/OSP_PUB/START_IZG_IG_IGA/IGA010/table/tableViewLayout1/.</u>
- (⁶⁴) 8.3 new STEM graduates per thousand population in 2022.
- (⁶⁵) Moreover, the drop-out rate in STEM and ICT fields is high due to low funding for living and weak qualitative skills of students. Source: Education at a Glance 2023: OECD Indicators, https://doi.org/10.1787/e13bef63-en.

financing (⁶⁶) to retain talent in Latvia. The draft human capital development action plan (⁶⁷) includes a number of initiatives, aimed at e.g. increasing the number and graduation rate of STEM students, that could help tackle this problem. However, it could be expanded with measures to attract and retain PhD students and researchers. In the short term, facilitating skilled migration could ease the high-skilled labour shortages (⁶⁸).

Graph A3.2: Number of doctoral entrants and graduates



Entrepreneurship education is well developed in Latvia, thanks to its policy prioritisation in recent years. Since 2014, fostering students' creative and entrepreneurial skills has been a priority of Latvia's educational policies, e.g. through the new skills-based curriculum. Also, entrepreneurship education has been embedded into national and regional education policies and initiatives, and the 2021-2027 education development

guidelines (EDG) emphasise the integration of entrepreneurial skills into the education system. Some challenges persist, such as cultural attitudes linked to a fear of failure.

^{(&}lt;sup>66</sup>) OECD Economic Surveys: Latvia 2024 https://www.oecd.org/en/publications/oecdeconomic-surveys-latvia-2024_dfeae75b-en.html

^{(&}lt;sup>67</sup>) Draft human capital development action plan 2025-2027: <u>https://tapportals.mk.gov.lv/legal_acts/2d477536f88c-439c-a768-7f9cb025f7d9#.</u>

^{(&}lt;sup>68</sup>) OECD Economic Surveys: Latvia 2022 <u>https://www.oecd.org/en/publications/oecd-</u> <u>economic-surveys-latvia-2022_co113448-en.html</u>

Table A3.1: Key innovation indicators

Latvia	2012	2017	2020	2021	2022	2023	2024	EU average (1)	USA
Headline indicator									
R&D intensity (gross domestic expenditure on R&D as % of GDP)	0.69	0.53	0.76	0.77	0.81	0.82	:	2.24	3.45
Science and innovative ecosystems									
Public expenditure on R&D as % of GDP	0.54	0.39	0.49	0.48	0.52	0.53	:	0.72	0.64
Scientific publications of the country within the top 10% most cited	3.54	3.64	3.94	4.55	:	:	:	9.64	12.29
Researchers (FTEs) employed by public sector (Gov+HEI) per thousand									
active population	3.30	3.00	3.47	3.78	3.36	3.15	:	4.24	:
International co-publications as % of total number of publications	31.13	41.11	51.45	48.74	49.02	48.74	:	55.92	39.34
R&D investment & researchers employed in businesses									
Business enterprise expenditure on R&D (BERD) as % of GDP	0.16	0.14	0.26	0.29	0.29	0.30	:	1.49	2.70
Business enterprise expenditure on R&D (BERD) performed by SMEs as %	0.11	0.10	0.15	0.16	0.12	:	:	0.40	0.30
Researchers employed by business per thousand active population	0.64	0.68	0.91	1.31	1.39	1.46	:	5.72	:
Innovative outputs									
Patent applications filed under the Patent Cooperation Treaty per billion	1.07	0.87	1.09	0.96	1.00			2 62	
GDP (in PPS €)	1.07	0.07	1.00	0.50	1.00	•	•	2.02	•
(%)	16.75	18.69	12.23	:	:	:	:	12.51	:
Digitalisation of businesses									
SMEs with at least a basic level of digital intensity % SMEs (ELL Digital Decade target by 2030; 90%)	:	:	:	:	52.27	:	59.18	72.91	:
Data analytics adoption						26.07		22.47	
% enterprises (EU Digital Decade target by 2030: 75%)	•	:	:	÷	÷	30.87	:	33.17	÷
Cloud adoption % enterprises (EU Digital Decade target by 2030: 75%)	:	:	:	22.21	:	29.04	:	38.86	:
Artificial intelligence adoption	:	:	:	3.72	÷	4.53	8.83	13.48	:
% enterprises (EU Digital Decade target by 2030: 75%)				•=					
Academia-business collaboration									
Public-private scientific co-publications as % of total number of nublications	4.30	5.91	7.57	8.78	9.04	8.55	:	7.71	8.90
Public expenditure on R&D financed by business enterprise (national) as %	0.05	0.03	0.04	0.04	0.06			0.05	0.02
of GDP Public support for business innovation	0.05	0.05	0.01	0101	0.00			0.00	0.02
Total public sector support for BERD as % of GDP	0.02	0.03		0.05	0.03			0.20	0.25
P&D tax incontinest foregone revenues as % of CDD	0.00	0.00	0.00	0.00	0.00	0.00		0.10	0.14
Not tax incentives. To regular revenues as % of GDP	0.00	0.00	0.00	0.00	0.00	0.00	•	0.10	0.14
BERD financed by the public sector (national and abroad) as % of GDP	0.02	0.03	:	0.05	0.03	:	:	0.10	0.11
Financing innovation									
Venture capital (market statistics) as % of GDP, total (calculated as a 3- year moving average)	0.01	0.02	0.01	0.02	0.02	0.02	:	0.08	:
Seed stage funding share (% of total venture capital)	0.00	19.90	18.10	13.00	19.80	18.90	:	7.30	:
Start-up stage funding share (% of total venture capital)	66.40	73.90	79.40	81.70	67.30	66.50	:	44.00	:
Later stage funding share (% of total venture capital)	33.60	6.20	2.50	5.20	12.90	14.60	:	48.70	:
Innovative talent									
New graduates in science and engineering per thousand population aged	14 35	8 4 2	8 44	8 73	8 30			17 58	
25-34	1	0.12		0.70	0.00			1.150	
Graduates in the field of computing per thousand population aged 25-34	2.93	2.62	2.65	3.01	3.17	:	:	3.63	:

(1) EU average for the last available year or the year with the highest number of country data

Source: Eurostat, DG JRC, OECD, Science-Metrix (Scopus database), Invest Europe, European Innovation Scoreboard.

ANNEX 4: MAKING BUSINESS EASIER

Latvia has brought forward reforms to improve its business environment, but several structural challenges remain. The economy faces labour shortages, especially in strategic sectors, which hinder long-term investment. Financial constraints persist due to restrictive lending and late business-to-(B2B) payments, although the business situation is improving. Latvia could boost investment by enhancing public transport expanding infrastructure and digital infrastructure. Administrative and regulatory barriers are higher than in Baltic peers. Digital infrastructure remains weaker in rural areas.

Economic framework conditions

Non-availability of skilled staff and labour shortages weigh on long-term investment in Latvia. According to the EIB Investment Survey (⁶⁹), 83% (the EU average is 77%) of Latvian businesses report a lack of skilled staff as a primary obstacle to long-term investment - this is higher than in Latvia's Baltic peers. Only 15% of firms in the industrial sector overall report labour shortages as limiting production (the EU average is 20%), but some economic sectors are heavily affected. For example, 37% of firms within the textile sector are constrained by labour shortages (the EU average is 16%). Strategically important sectors which are relevant for the twin transition also face a lack of skilled workers (70), especially in STEM and ICT professions (⁷¹) (see Annex 12). The Latvian authorities have started to address the issue by implementing structural reforms which aim to increase mobility from regions with high unemployment (see Annex 17). Latvia's recovery and resilience plan (RRP) includes reforms to improve higher education and adult learning (see Annex 10).

Restrictive lending and late B2B payments are financially constraining Latvian firms, but the situation is improving. The gap between the payment terms offered to businesses and actual payments is one of the largest in the EU. According to the most recently available data (⁷²), the average gap for B2B payments was 16.2 days in 2023 - above the EU average and one of the highest in the EU. The public sector payment gap has improved significantly since 2022 and stood at 12 days in 2023, the second best in the EU. Overall performance is still far from that in 2019, when the average gaps were only two days and four days respectively (73). Moreover, 18.2% of Latvian businesses report payment delays from the public sector (EU average 16.6%) and 59.4% report that they experienced late payments in B2B activities (EU average 47.9%, see Graph A4.1). According to the EIB Investment Survey, 58% of Latvian enterprises reported the non-availability of finance as an obstacle to long-term investment in 2024 (the EU average was 45%). This is a slight improvement on 2023 (62%) but is also the highest value among the three Baltic Member States and is one of the highest in the EU (see Annex 5). According to the EIF loan index, Latvia ranks 25th in the EU when it comes to the accessibility of loans for SMEs.

Latvia could boost private-sector investment by improving public transport infrastructure and continuing the expansion of digital infrastructure. According to the World Bank's Logistics Performance Indicator, Latvia has room to improve its transport infrastructure, where it is lagging behind its Baltic peers (⁷⁴). 48% of Latvian firms report transport infrastructure as an impediment to long-term investment, trailing Lithuania (42%) and Estonia (26%) (⁷⁵). Given its geopolitical situation, the

^{(&}lt;sup>69</sup>) <u>EIB Investment Survey 2024</u>: European Union overview.

^{(7°) &}lt;u>Republic of Latvia: 2024 Article IV Consultation-Press</u> <u>Release; and Staff Report.</u>

⁽⁷¹⁾ OECD Economic Surveys: Latvia 2024 | OECD.

^{(72) &}lt;u>European Payment Report 2023</u> Key findings on late payments, inflation & business growth.

⁽⁷³⁾ European Payment Report 2023 | Key findings on late payments, inflation & business growth.

⁽⁷⁴⁾ International Scorecard Page | Logistics Performance Index (LPI)

⁽⁷⁵⁾ EIB Investment Survey 2024 - European Union overview

Latvian economy could profit from and attract investments by deepening more its connections with the rest of the EU. The RRP is supporting the completion of the southern part of Riga Railway Central Station in order to ensure connectivity by rail between Riga Airport and the main Rail Baltica line (⁷⁶). This is a significant opportunity to address substantial investment shortfalls in transport infrastructure (including complementary investments in inland, airport and seaport links) as well as digital infrastructure (e.g. the fibre optic cable line along the railway) (⁷⁷). Digital infrastructure has been improving, but Latvia is still lagging behind the EU when it comes to meeting the Digital Decade targets (although business digitalisation has recently accelerated (78).

Graph A4.1: Making Business Easier: selected indicators.



Share of (1) enterprises, (2) average intra-EU exports and imports in GDP, (3) firms, (4) SMEs. *Sources:* (1) EIB IS, (2) Eurostat, (3) ECFIN BCS, (4) SAFE survey.

Digital infrastructure is catching up quickly with EU average levels but challenges remain, especially in rural areas. Latvia's connectivity has rapidly improved in recent years but still falls short of EU averages (⁷⁹). Very high capacity network (VHCN) coverage reached 71.5% in 2023. This was still below the EU average of 78.8%, but grew strongly that year by 13.9% (the EU average was 7.4%). Similarly, fibre to the premises coverage was 61.9% (slightly below the EU average of 64%) but grew only slightly during the year. 5G coverage remained low at 53.1% (the EU average was 89.3%) but grew quickly (26.5%). Public investment is taking place, but strong regional disparities persist and challenges such as low population density are hampering private investment in digital infrastructure in rural areas. When it comes to cyber-security,

^{(&}lt;sup>76</sup>) <u>Annex to the Council Implementing Decision amending</u> <u>Implementing Decision of 13 July 2021 on the approval of</u> <u>the assessment of the recovery and resilience plan for</u> <u>Latvia.</u>

⁽⁷⁷⁾ OECD Economic Surveys: Latvia 2024 | OECD.

^{(78) &}lt;u>Report on the state of the Digital Decade 2024 | Shaping</u> <u>Europe's digital future</u>.

^{(79) &}lt;u>Latvia 2024 Digital Decade Country Report | Shaping</u> <u>Europe's digital future</u>.

awareness among enterprises is increasing and 89% of companies deploy ICT measures (the EU average is 92.8%).

Regulatory and administrative barriers

Reforms are being brought forward to ease the administrative and regulatory burden for businesses, but it is still perceived to be higher than in Latvia's Baltic peers (80). 40% of businesses in Latvia reported business regulation as a major obstacle to investment (the EU average was 22%) (⁸¹), by far the highest value among the Baltic Member States (Estonia: 15%; Lithuania: 13%). As concerns the OECD's Product Market Regulation indicators, Latvia performs below the OECD average in the areas of competition assessment of new regulation and market entry barriers in service sectors. The procedures for obtaining licences permits can be improved (⁸²). The and construction sector is especially suffering from unnecessarily long and complex procedures. According to a survey conducted by the Bank of Latvia among real estate developers, acquiring all the documentation needed for the construction process takes much more time in Latvia than in Estonia or Lithuania (⁸³). To tackle these issues, the Latvian authorities have included measures in their medium-term fiscalstructural plan to detect excessive overall administrative burden and to streamline regulatory processes in the real estate sector (⁸⁴).

The costs of ensuring tax compliance are aligned with the EU average or slightly below, pointing to an efficient tax collection system. The costs of complying with direct and indirect tax requirements represent between 1% and 2% of businesses' turnover. This is close to the EU average of 1.9%. In terms of absolute numbers, Latvian enterprises face lower compliance costs than the EU average, for corporate income tax and value added tax (⁸⁵) (see Annex 2).

The transposition of EU legislation into national law is an opportunity to further accelerate business dynamism. According to the OECD, Latvia's insolvency framework involved costly and inefficient procedures that impeded the productive reallocation of resources (⁸⁶). Since March 2023, the Latvian authorities have transposed the Restructuring and Insolvency Directive (EU) 2019/1023 into Latvian laws that now apply to all proceedings which have been filed since September 2023. The overall churn rate of Latvian businesses was already guite high and above the EU aggregate in recent years, which indicates a higher level of business dynamism (87). The new insolvency framework is expected to have a positive impact, so this development could be enhanced even further.

The entrepreneurial environment has faced significant challenges in recent years. The Global Entrepreneurship Monitor 2024 shows that Latvia's entrepreneurial environment has stagnated with downward tendencies. Latvia's National Entrepreneurial Context Index score fell from 5.3 in 2022 to 5.1 in 2024 (⁸⁸). In particular, the rankings for entrepreneurial education at school (see Annex 12), ease of market entry and government policy support have fallen sharply (⁸⁹) since 2022. Latvia nevertheless still ranks 14th among GEM economies.

^{(&}lt;sup>80</sup>) <u>Responsive administration and burden of regulation </u> <u>Single Market Scoreboard</u>.

^{(81) &}lt;u>EIB Investment Survey 2024 - European Union overview</u>

⁽⁸²⁾ Latvia_PMR country note.

^{(83) &}lt;u>Financial Stability Report 2023</u>.

⁽⁸⁴⁾ Latvijas Fiskāli strukturālais plāns 2025.-2028. gadam.

^{(&}lt;sup>85</sup>) <u>Tax compliance costs for SMEs - Publications Office of the</u> <u>EU</u>.

⁽⁸⁶⁾ OECD Economic Surveys: Latvia 2024 | OECD.

^{(&}lt;sup>87</sup>) DG ECFIN Productivity fiche, 2025.

⁽⁸⁸⁾ Global Entrepreneurship Monitor 2024/2025 Report: Fear of failure and slow AI adoption holding back entrepreneurs in Latvia | Stockholm School of Economics in Riga.

^{(&}lt;sup>89</sup>) Entrepreneurship in Latvia - GEM Global Entrepreneurship Monitor.

Single market

Latvia is well integrated into the single market, with its average total trade with other EU countries accounting for more than half of its GDP in 2023. The share of single market directives which are incorrectly transposed into national law equals the EU average of 0.8% and Latvia is the best performer when it comes to the conformity of its transpositions (it has a deficit of zero). There only 10 infringement proceedings were pending in 2023, which was the joint best value in the EU (Estonia and Luxembourg also had 10 proceedings pending; the EU average was 26). Moreover, the Latvian SOLVIT centre has managed to resolve 100% of its cases (the EU average is 84.9%).

Public procurement

The public procurement framework faces several structural challenges, but reforms are being made. Latvian public procurement institutions face significant staff-related problems, including suboptimal staff resources, low and uncompetitive salaries, and insufficient training opportunities. These issues can lead to and delays, inefficient public spending difficulties in attracting and retaining skilled procurement professionals. The planning process suffers from issues of planning, allocated time for procurements, the workload distribution for procurers, and short contract durations (⁹⁰). The Latvian public procurement could system benefit from greater centralisation. The purchase of standardised goods and services (e.g. ICT, software services and medical drugs) is currently still being done by multiple municipalities (⁹¹). Latvia has introduced an advisory council for public procurement to tackle these issues and

continues to implement measures from its RRP that aim to enhance the professionalisation of procurers as well as the centralisation of public purchasing (⁹²).

Significant progress has been achieved in implementing socially responsible public procurement (SRPP) in recent years. Latvia has produced a wide range of resources to help procurement officers in effectively applying SRPP. These resources include the development of guidelines, the creation of training materials, the compilation of international best practices in SRPP, and the provision of practical models to inspire and guide efforts.

Few professions appear to be more strictly regulated than in other OECD countries. Latvia has stricter regulatory barriers for lawyers and notaries. These take the form of total bans on lawyers and notaries engaging in multidisciplinary activities (⁹³). Latvia could foster competition by reducing regulatory barriers, particularly in retail sale of medicine, air transport and natural gas (⁹⁴).

^{(9°) &}lt;u>29780-OFPKvdMM5yj8IVWkSjikQc1NAGv2VsPS.pdf</u> (machine translation).

⁽⁹¹⁾ OECD Economic Surveys: Latvia 2024 | OECD.

⁽⁹²⁾ OECD Economic Surveys: Latvia 2024 | OECD.

^{(93) &}lt;u>eur-lex.europa.eu/legal-</u>

content/EN/TXT/PDF/?uri=CELEX:52021DC0385.

⁽⁹⁴⁾ Latvia_PMR country note.

		Latvia						
POLICY AREA	INDICATOR	NAME	2020	2021	2022	2023	2024	EU-27 average
	I	Investment cli	mate					
	Material shortage, firms facing constraints, % ¹		7.8	16.1	22.9	12.9	11.0	10.0
Shortages	Labour shortage, firms fac	ing constraints, % ¹	12.1	21.4	22.7	17.3	15.3	20.2
	Vacancy rate, vacant posts available ones (vacant + oc	as a % of all ccupied) ²	2.0	2.7	2.7	2.4	2.2	2.3
	Transport infrastructure as investment, % of firms rep obstacle ³	s an obstacle to orting it as a major	23.2	25.4	25.5	29.9	25.2	13.4
Infrastructure	VHCN coverage, % ⁴		-	62.5	62.7	71.4	-	78.8
	FTTP coverage, % ⁴		-	60.7	60.9	61.9	-	64.0
	5G coverage, % ⁴		-	0.0	42.0	53.1	-	89.3
	Reduction	n of regulatory and a	dministrat	ive barrie	rs			
Regulatory environment	Impact of regulation on lou % firms reporting business major obstacle ³	ng-term investment, regulation as a	34.7	50.3	25.9	39.8	41.8	24.5
	Payment gap - corporates days between offered and	B2B, difference in actual payment ⁵	15.8	10.8	16.0	16.2	-	15.6
	Payment gap - public sector, difference in days between offered and actual payment ⁵		18.4	8.7	13.3	12.0	-	15.1
Late payments		from public or private entities in the last 6 months	36.5	36.5	38.1	50.6	-	-
	Share of SMEs experiencing late payments, % ^{*⁶}	from private entities in the previous or current quarter	-	-	-	-	59.4	47.9
		from public entities in the previous or current quarter	-	-	-	-	18.2	16.6
		Single Mark	et					
Integration	EU trade integration, % (Av imports + average intra EU	verage intra-EU exports)/GDP ²	43.5	48.2	57.7	50.5	49.1	41.6
integration	EEA Services Trade Restrictiveness Index ⁷		0.047	0.035	0.035	0.035	0.039	0.050
	Transposition deficit, % of transposed ⁸	all directives not	0.8	2.0	1.2	0.5	0.8	0.8
	Conformity deficit, % of all transposed incorrectly ⁸	directives	1.0	1.0	0.8	0.4	0.0	0.9
Compliance	SOLVIT, % resolution rate	per country ⁸	100	100	100	100	100	84.9
	Number of pending infring	ement proceedings ⁸	22.0	17.0	12.0	10.0	10.0	24.4
		Public procure	ment					
Competition and	Single bids, % of total cont	ractors** ⁸	25	26	37	28	22	-
procurement	Direct awards, %** ⁸		8	11	8	8	7	7.0

Table A4.1: Making Business Easier: indicators.

*Change in methodology in 2024: reporting late payments from public and private entities separately.

**Data on single bids for 2024 is provisional and subject to revision. Due to missing data, the EU average of direct awards data is calculated without Romania.

Sources: (1) ECFIN BCS, (2) Eurostat, (3) EIB IS, (4) Digital Decade Country reports, (5) Intrum Payment Report, (6) SAFE survey, (7) OECD, (8) up to 2023: Single Market and Competitiveness Scoreboard, 2024: Public procurement data space (PPDS).

ANNEX 5: CAPITAL MARKETS, FINANCIAL STABILITY AND ACCESS TO FINANCE



Latvian firms do not have access to the relatively low savings of households, as direct retail participation in capital markets is extremely low. At the same time, the investment policies of domestic institutional investors are conservative and oriented abroad. longstanding Moreover, structural issues constrain bank lending in Latvia. This leaves internal financing as the main alternative for Latvian firms. However, over the last decade, the private equity and venture capital sector has played a key role in diversifying corporate financing. With this relatively well-developed local venture and growth capital market, Latvia is currently among the most start-up friendly countries in the world, and strives to further develop its strategy, with a unique role for FinTech in it. Latvia's banking sector is very small, highly concentrated, and partly dependent on developments in foreign parent banks. Overall, it exhibits high resilience to risks and low exposure to vulnerabilities.

Availability and use of domestic savings

In 2021, Latvia switched from a net foreign lender to a net borrower. Over the last decade, the private savings ratio, net of fixed capital consumption, fluctuated around its tenyear average of 6.2% of GDP, reaching a maximum of 10% in 2021 (see Graph A5.1). The net private investment ratio, which measures the net contribution of the private sector to capital accumulation in the country, exhibited a ten-year average of 3.0% of GDP and reached a maximum of 5.4% in 2021. At the same time, during the same period the government balance was in regular surplus, averaging 0.8% of GDP. Until 2020, the balance between net domestic savings, net investment, and the structural government deficits was positive, resulting in net lending by Latvia averaging 0.8% of GDP, with a peak of 4.8% in 2020. Hence, some of Latvian net savings, i.e. after accounting for the investments that are necessary to merely maintain the existing

capital structure of the economy, were used to finance projects abroad until 2020. In 2021 the situation changed and Latvia became a net borrower from the rest of the world.



The Latvian economy exhibits a negative net international investment position. Between 2009 and 2023, the NIIP strengthened almost every year, reflecting an improvement in international competitiveness, however remaining in negative territory. As of Q3-2024, total assets on foreigners reached 141% of GDP, while liabilities to foreigners stood at 163% of GDP, resulting in a NIIP equivalent to -22.1% of GDP (see Graph A5.2). The accumulated net portfolio investment, which reached 25.5% of GDP as of Q3 2024 and the stock of official foreign reserve assets amounting to 12.1% of GDP did not suffice to counterbalance a negative accumulated net foreign direct investment balance of -48.8%, together with net other investments of -10.8%. Thus, the Latvian economy has systematically been a net capital importer, notably mainly by means of direct foreign investments into the country.



Structure of the capital markets and size of the financial sector

In terms of capital market development, Latvia lags behind not only the rest of the EU, but also neighbouring countries. Despite a similar economic structure and size, stock exchanges of Estonia and Lithuania have been able to achieve a higher level of development. Whereas the market capitalisation of listed stocks in Estonia reached 12.2% at the end of Q3-2024, and 5.9% in Lithuania, it was only 1.2% of GDP in Latvia, among the smallest percentage in the EU. In comparison, the EU average is 69.3% of GDP. Whereas state and local government-controlled companies account for slightly more than a third of market capitalisation Lithuania and Estonia, Latvia has only listed bonds for three state-owned enterprises. The situation is similar in the debt securities market: the corporate bond market is very thin and activity there was very weak even when low interest rates prevailed in financial markets over the previous decade.

Graph A5.3: **Capital markets and financial intermediaries in Latvia**



capital The prospects for market development are limited by the low number of listed enterprises. Latvia has established a good market infrastructure, as well as a regulatory framework that meets international standards, ensuring adequate market and transparency investor protection. Nevertheless, local businesses tend to rely for external funding on bank intermediation rather than attracting investments through stock and bond issues or from alternative sources. This results in few local investment opportunities, low interest from institutional and retail investors, and thus few local opportunities to raise share capital. Lacking market activity by institutional investors lowers demand for corporate stocks and bonds. In terms of the international market, projects developed in Latvia are relatively low value, which makes them less attractive to international investors.

Latvia's monetary financial sector is very small compared with the EU average and concentration is high. At the end of Q3-2024, banks' total assets were equivalent to 71.2% of GDP, significantly below the EU average of 248.1% and also below the level reached in 2017 (105%). The sector has been shrinking as banks servicing non-residents have significantly downsized their operations following the introduction of stricter anti-money laundering rules. Consequently, their business volumes and deposits have notably decreased. This has led them to transform their business models. The banking sector is highly concentrated, and borrowing costs are among the highest in the EU in almost all lending segments. The top five MFIs represent more than 88% the sector, vs. an EU average of 54%. The Latvian banking sector is dominated by subsidiaries and branches of banks from Nordic and Baltic countries. Notably, Swedbank (95) and SEB Banka, which are the two largest banks in Latvia, are Swedish owned. Due to its integration with the Nordic and Baltic banking systems, the financial sector of Latvia depends partly on developments in parent banks and their strategic decisions. Latvia's banking sector may be exposed to spillover risks from these regions. In Sweden and other Nordic countries, imbalances on the real estate market, as well as high private debt levels are potentially destabilising elements.

The role of the non-bank financial sector in the financial sector and the economy is still considerably less important as compared to other euro area countries. This is primarily due to the low level of long-term savings of the population and the low financial literacy level. Total assets of insurance corporations against GDP amounted to 4.1% at the end of Q3-2024, vs. an EU average of 54.8%. Most of the pension fund assets in Latvia consist of funds accumulated in state-funded pension plans, which at the end of 2023 had accumulated to about half of the total assets of the non-bank financial sector. According to Latvijas Banka's financial accounts statistics, in 2023 the assets, respectively liabilities, of the participants of Latvia's non-bank financial sector accounted for 12.3%, respectively 10.7%, of those of credit institutions.

Resilience of the banking sector

Overall, the Latvian banking sector exhibits high resilience to risks. Latvia's banking sector has coped relatively well with the multiple shocks in recent years, from the pandemic crisis to Russia's aggression against Ukraine and the energy crisis. The sector's resilience is bolstered by strong capitalisation and asset-quality metrics, with a capital adequacy ratio of 23.8% in Q3-2024, well above the EU average of 20.1% (see Table A5.1). The improvement came through the accumulation of high-quality lossabsorption capital, as the CET1 ratio increased from 20.5 % in 2023 to 22.5% in Q3-2024, significantly above the EU average of 16.6%. The three institutions that were subject to the 2023 EU-wide stress test (Swedbank AS, AS Citadele banka, and AS SEB banka) passed successfully even the most adverse scenario. According to Latvijas Banka, despite dividend pay-outs, significant credit institutions maintain sufficiently high voluntary capital buffers to absorb shocks. Given the current level of voluntary buffers of credit institutions and their ability to still capitalise profits, it is expected that no credit institution will have difficulties in meeting MREL targets in 2024. Additionally, capital buffers are supported by the decision of the Latvian Central Bank in December 2023 to implement a positive neutral Countercyclical Capital Buffer rate. This rate has been set at 0.5% starting in December 2024 and will increase to 1% in June 2025. The stress test results for other credit institutions have generally improved, with a decline in the level of non-performing loans on the balance sheets of some institutions. The resilience to market risk, including the revaluation of securities held to maturity at current market value, has improved. Overall, the most important systemic risks to the stability of the financial sector remain related to the persistently weak economic activity and generally tight credit conditions, which may affect bank customers, especially non-financial corporations, and limit the recovery of economic growth in the medium term.

⁽⁹⁵⁾ In October 2021, the ownership of the subsidiary banks in Estonia, Latvia and Lithuania was placed in the holding company Swedbank Baltics AS which is wholly owned by Swedbank AB, and which is under the supervision of the European Central Bank.

The profitability of credit institutions is high. In Q3-2024 Latvian banks have achieved a record-high return on equity ratio (18.1%), significantly exceeding the EU average (10%). The sharp rise in market interest rates, the dominance of floating-rate loans, together with the still resilient quality of the loan portfolio have led to this significant increase in banks' profitability. Although the positive factors have more than offset the negative ones, the latter have also been considerable, namely an increase in bank's expenses over 2023 (driven by staff pay rises, inflation and expenditures on consultancy and other services in some credit institutions), as well as the amendment to the Corporate Income Tax Law, the first payment of which was made in 2023. In 2024, profits have been affected somewhat by the mortgage protection fee (⁹⁶), but still stood well above the EU average. The return on equity ratio as of end Q3-2024 stood at 18.1%, vs. an EU average of 10%.

Banks' balance sheets show improved asset quality. With an aggregate non-performing loan (NPL) ratio of 1.2% in Q3-2024, which is below the EU average of 1.9%, credit quality has improved significantly over the past decade. With inflation easing and income growth remaining strong, households' financial situation is gradually improving. Additionally, mortgage protection is also reducing the default risks. At the same time, the solvency and debt-servicing capacity of non-financial corporations has weakened somewhat due to weak economic activity and sharply higher labour and financing costs. Nevertheless, NPLs have remained low, partly thanks to

renegotiations and financial hardship relief to prevent (sometimes pro-actively) the problems from taking root, avoiding as far as possible a further migration of some distressed loans to NPLs. Yet, banks' aggregate coverage ratio of NPLs by existing provisions remains short of the EU average by almost 13 percentage points, even though it increased from 26.2% in 2021 to 29% in Q3-2024, improving the resilience of credit institutions in the event of a potential deterioration in loan quality.

Funding risk remains low in general and liquidity ratios remain at a good level. The loan-to-deposit ratio is low (74.5% in Q3-2024 vs. 106.7% for the EU) as domestic deposits exceed issued loans significantly. Thanks to the strong and stable domestic customer-deposit base, credit institutions do not need to draw on additional funding from financial markets nor do they rely heavily on their cross-border parent banking groups. The liquidity coverage ratio amounted to 167% in Q3-2024, well above the minimum requirement. Banks have accumulated large amounts of liquid assets. This is partly driven by moderate lending growth.

Resilience of the non-bank financial intermediaries

Overall, the ability of insurance corporations to absorb potential shocks remains good, as their solvency capital ratios remain high. A source of uncertainty to insurers is the purchasing power of consumers, particularly as the frequency of natural disasters increases and the scope of policy coverages widens. Crossborder operations are crucial for Latvian insurance companies, similar to those in other small markets, as they aid in risk diversification and management. Although non-life insurers have managed to pass on the cost increases to their customers, the declining contributions and the attractiveness of other investment products in times of rising interest rates put the

^{(&}lt;sup>96</sup>) The Latvian Parliament, on 6 December 2023, passed measures to assist mortgage borrowers by reducing their interest payments for one year by 30%, with a maximum of 2 percentage points of the interest rate for a given period. The measure is broad-based and aimed at short-term relief (for a period of one year). To finance the measure, a one-off fee of 0.5% of the total amount of mortgage loan balances will skim profits from banks and credit providers operating in Latvia in 2024.

sustainability of the life insurance business under pressure.

Sources of business funding and the role of banks

Firms in Latvia rely less than the EU average on funding from capital markets and bank lending. The relative significance of bank credit to businesses continues to decline, with companies in Latvia utilising bank loans less than any other EU country. At the end of 2023, MFI credit accounted for merely 15% of the total corporate debt portfolio, down from 34% in 2010, and among the lowest in the EU. Listed shares and bonds represented only 1.3% of all funding sources for Latvian non-financial corporations. The equivalent figures for the EU average are 27.2% and 23.8%, with the overall levels also substantially higher as a share of GDP (as the overall level of non-financial corporations funding was 137% in Latvia and 230% of GDP for the EU average, see Graph A5.4). The market funding ratio (97) as of end 2023 was 21.2%, compared to an EU average of 49.6%.

Graph A5.4: Composition of NFC funding in % of GDP



The sum of NFC liabilities only reflects the total for the NFC liabilities considered. Reference period 2023. **Source:** Eurostat and FISMA E2 calculations

At the same time, 24% of all Latvian firms believed that their investment activities over the last 3 years were not sufficient. This is together with the other two Baltic countriesone of the highest levels of underinvestment among the EU (EU average of 14%), suggesting that there is a financing gap relative to investment demand, especially for SMEs. Moreover, the country has a high share of finance-constrained firms (14%). State guarantees, e.g. from the public investment agency ALTUM, help bridge the financing gap, but collateral requirements imposed by banks remain stringent. This leaves internal financing as the main alternative to bank funding for Latvian firms. According to the 2024 EIB Investment Survey, 74% of Latvian firms' investment needs are covered by internal funding, compared to an EU average of 66%.

The financial cycle in Latvia slowed down in 2023, and corporate credit growth went negative. Credit growth has been on a general downward path, both for households (since June 2022) and non-financial corporations (since November 2022). Demand from borrowers declined as a result of higher

⁽⁹⁷⁾ i.e. the volume of corporate bonds and listed shares of NFCs relative to the volume of those two and bank loans to NFCs.

interest rates, and heightened uncertainty. Over 2024 credit growth recovered, as lending standards eased on the back of expectations of monetary policy easing. For households, the annual credit growth rate for adjusted loans has gradually edged up from 2.6% in June 2024 to 5.9% in November 2024. For NFCs, annual credit growth recovered from -3.4% in November 2023 reaching 4% in November 2024. Nevertheless, lending in Latvia remains sluggish, with outstanding loans to NFCs and households fluctuating around 27% of GDP. This is nearly 3 times below the euro area average.

Beyond the cyclical factors and monetary policy tightening, longstanding structural issues further constrain lending in Latvia. These issues are reflected in high lending rates and stringent collateral requirements, most notably in the corporate lending segment where interest rate markups have remained high and, combined with a large share of variable interest rate loans, have resulted in very high lending rates. Concentration is amongst the highest in the EU according to the five-firm concentration ratio. To reduce high credit costs, it is key to foster competition in financial markets by reducing information asymmetries and switching costs for bank customers and strengthening competition enforcement.

This reduces corporate demand for bank loans and forces them to rely on their own funds as well as other alternatives (other equity). Limited access to finance coupled with high informality is reflected in the 2024 SAFE survey results. In that survey 30% of Latvian SMEs indicate that bank loans are relevant for them, compared to an EU average of 45%, and 29% of SME's indicated that equity (other than shares) is relevant for them vs. an EU average of 12% (⁹⁸). Internal financing accounted for the largest share of finance for firms in Latvia in

(98) Data and surveys - SAFE - European Commission, 2024, Results by country, T23, T27. 2023. Alternative financial service providers are competing and often outcompeting the traditional ones at high speed. Conducted empirical analysis shows that the most available financing sources in Latvia, apart from banking products, are friends and family, venture capital, business angels, as well as diverse state support programmes (including EU grants, Altum). However, Altum's loan portfolio is relatively small against the total value of outstanding loans (a mere 2.5% as of mid-2023).

Capital markets and the participation of retail investors

SMEs find it difficult to access and take advantage of Latvia's capital markets. In the 2024 SAFE survey 41% of SMEs indicated that internal funds (retained earnings or sale of assets) are relevant for them, compared to an EU average of 30% (⁹⁹). While the Nasdag First North Market offers a trading facility with reduced reporting requirements, targeting primarily smaller cap issuances, SMEs and startups seeking to list on it face a significant challenge due to the mandatory biannual audit of their financial statements. Moreover, Latvia cannot take advantage of this SME market because there are no established SME growth markets in Latvia, nor in the other Baltic states. Recently, work started on setting up an SME Initial Public Offering Fund in the Baltics, with the help from ALTUM for Latvia and ILTE for Lithuania.

The government is currently reviewing its strategy for activating capital markets, including several lines of action to meet the ambitious target of stock market capitalization of 9% of GDP by 2027. This initiative is part of a broader strategy to leverage over 10 billion EUR in household

⁽⁹⁹⁾ Data and surveys - SAFE - European Commission, 2024, Results by country, T20.

savings across Latvia, directing these funds towards vital investments that can spur sustainable economic growth. Government decisions made earlier in 2021 and 2022 foresee specific instruments to increase the capitalisation of the stock market and promote capital attraction and the entry of new issuers into the stock exchange. From the 10-step programme, concrete action plans were derived and included in the National Financial sector Development Plan for 2021-2023. In May 2023 the government of Latvia approved the initiative "On further development of the Latvian capital market" to meet the target of stock market capitalization of 9% of GDP by 2027. Since then, progress has been made, but clearly there is potential for further improvement. More work is needed to open possibilities for domestic and foreign capital flows to fund business investment, to provide investors with an opportunity to invest in the development of the Latvian economy. In February 2025 the Bank of Latvia updated the 10-step programme stating that measures should be taken to promote the entry of large state-owned municipalities-owned or companies into the capital market, notably by including shares in the market.

Graph A5.5: **Composition of household financial assets per capita and as % of GDP**



The sum of household assets only reflects the total for the HH assets considered. Reference period 2023. **Source:** Eurostat and FISMA E2 calculations.

One reason the level of activity in the capital markets is so low is that the levels of income and savings are relatively low. It is also important to note that the outstanding deposits at banks significantly exceed the outstanding loans from banks, which may point to untapped potential since those savings could be redirected towards capital markets. Another reason why the development of the capital markets has been weak is that there is little, or at times no, interest from international investors. For the local capital markets to come onto their radars, they would first need to reach a sufficient level of capitalisation. Listing of large state-owned enterprises and facilitating greater exposure of pension funds to domestic securities could help attract investors and raise access to finance.

The role of domestic institutional investors

The role of the non-bank financial sector in the financial sector and the economy is still considerably less important as compared to other EU countries. The Latvian insurance market is relatively small compared to the EU. Total assets of insurance corporations against GDP amounted to 4% end of Q2-2024 (vs. 53.4% EU average). Although the state funded pension scheme is still in the phase of the build-up of savings, household savings for retirement account for the largest share of the non-bank financial sector's assets. Data show that in relation to GDP, at the end of Q2-2024, Latvia's pension savings in all types of pension products (22.3%) exceeded Lithuania's (11%), and also slightly Estonia's (19% in 2019). Most of the pension fund assets in Latvia consist of funds accumulated in state-funded pension plans, which at the end of 2023 had accumulated to almost half of the total assets of the non-bank financial sector. Due to the growing contributions to the 2nd pillar pension scheme, the high return on investment, as well as the licensing of investment platforms in 2021, the role of Latvia's institutional investors has been growing over recent years.

Pension funds have contributed to the development of the Latvian capital markets, but their domestic investment remains low. About half of the portfolio of Latvian pension assets is bills and bonds, indicating a more conservative and mostly foreign investment profile as the local corporate bond market is shallow. Although the investment rules of second-pillar pensions have already been relaxed, equity investment limits for plans registered before the end of 2017, and private investment fund limits are still 50% and 25%, respectively. Moreover, second-pillar pension management companies cannot invest directly in real estate and face low concentration limits on equity holdings (¹⁰⁰). Encouraging the buildup of universal funded supplementary pension schemes would positively contribute to (i) the sustainability and adequacy of pension benefits; (ii) investment in equity; (iii) access to finance; (iv) growth; and (v) innovation.

Strengthening insurance markets could also help deepen capital markets and close the funding gap of insurance companies. The Latvian insurance sector mainly invests in collective investment schemes, at 40% of total assets by end 2023 (compared to 19% for the EU as a whole), with another 38% held in government bonds, 8% in corporate bonds, 8% held in cash and deposits (¹⁰¹). However, the pool of premiums collected by insurance companies is very small in Latvia, which limits their contribution as potential buyers of securities in private capital markets. Health insurance coverage is weak, and life insurance funds are also small compared to EU countries due to low household savings and competition from voluntary contribution (third pillar) pension funds, which are mostly managed by large bank subsidiaries.

The participation of domestic institutional investors in providing funding for start-ups and venture capital investors is increasing. Funds raised from pension funds have increased considerably, while capital is also being raised from less traditional sources such as endowment funds and general partners commitments. Recent data show that pension funds in Latvia accounted on average for 15% of private equity and venture capital funds raised over 2023, a figure that is in line with the one for the other Baltic states and close to +20% shares for Nordic states (¹⁰²).

The depth of venture and growth capital

Although the venture capital sector has developed rapidly, it still lags the EU average and depends on public co-funding. According to the Capital Market Union Dashboard, Latvia lags Europe in annual venture capital investments relative to GDP, with 0.02% on average annually over the period 2021-23 (vs. an EU average of 0.08%). Equally, the country lags in terms of annual private equity investments relative to GDP (0.01% of GDP per year on average over 2021-23 vs. an EU average of 0.06%). However, Latvia is an outlier in terms of making use of crowdfunding platforms. They represent 0.7% of GDP according to the latest data available (EU average 0.1%). In 2023, Latvian start-ups raised EUR 758 million which was predominantly driven (¹⁰³). by venture capital The establishment of venture capital funds in Latvia, as in the other Baltic countries, takes place through co-investments from the state budget, EU funds, the EBRD and the European Investment Fund, pension funds, and private

⁽¹⁰⁰⁾ OECD (2023), <u>Annual Survey of Investment</u> <u>Regulation of Pension Providers 2023</u>,

⁽¹⁰¹⁾Source: Latvijas Banka (2024), Key numbers of the Latvian insurance sector Q4-2023.

^{(&}lt;sup>102</sup>) Source: <u>Closing the gaping hole in the capital</u> market for EU start-ups – the role of pension funds – <u>CEPS</u>.

⁽¹⁰³⁾Source: KPMG, LTVC, LVCA, ESTVCA, 2024, Baltic Private Equity and Venture Capital Market Overview 2023.

Table A5.1: Financial indicators

		2017	2018	2019	2020	2021	2022	2023	2024-Q3	EU
	Total assets of MFIs (% of GDP)	108.8	81.0	76.8	82.4	76.8	74.9	71.3	71.2	248.4
	Common Equity Tier 1 ratio	18.4	20.3	22.0	25.7	29.2	23.6	20.5	22.5	16.6
	Total capital adequacy ratio	20.6	22.3	23.4	26.8	29.7	24.1	21.6	23.8	20.1
-	Overall NPL ratio (% of all loans)	5.6	5.3	3.9	4.6	2.1	1.4	1.3	1.2	1.9
g	NPL (% loans to NFC-Non financial corporations)	10.4	9.1	7.3	5.9	3.1	2.6	2.0	1.8	3.5
se	NPL (% loans to HH-Households)	5.9	5.2	4.2	3.7	1.3	0.8	0.9	1.0	2.2
ing	NPL-Non performing loans coverage ratio	35.9	33.0	30.3	28.8	26.2	28.4	28.8	29.0	42.1
ank	Return on Equity ¹	7.6	9.2	9.6	5.2	4.5	10.2	20.3	18.1	10.0
-	Loans to NFCs (% of GDP)	22.6	19.8	18.3	17.1	15.4	15.1	13.8	13.6	30.0
	Loans to HHs (% of GDP)	20.2	17.6	16.9	17.1	16.7	15.6	14.8	15.1	44.5
	NFC credit annual % growth	2.7	3.9	-0.8	-1.0	-0.8	10.0	-1.5	2.3	0.8
	HH credit annual % growth	0.5	0.8	1.3	0.5	6.3	3.8	2.9	5.2	0.7
	Stock market capitalisation (% of GDP)	4.8	2.7	2.8	3.3	3.1	2.1	1.9	1.2	69.3
	Initial public offerings (% of GDP)	0.09	0.00	0.00	0.00	0.38	0.12	0.06	-	0.05
	Market funding ratio	12.9	13.7	15.6	16.5	21.1	20.7	21.2	-	49.6
P	Private equity (% of GDP)	0.67	0.03	0.04	0.09	0.06	0.13	0.09	-	0.41
ect	Venture capital (% of GDP)	0.00	0.01	0.02	0.01	0.03	0.02	0.01	-	0.05
S	Financial literacy (composite)	-	-	-	-	-	-	36.0	-	45.5
an	Bonds (as % of HH financial assets)	1.0	0.9	0.9	0.8	0.6	0.6	1.0	-	2.7
q L	Listed shares (as % of HH financial assets)	0.9	0.7	0.7	1.0	1.4	1.1	1.2	-	4.8
Ŷ	Investment funds (as % of HH financial assets)	1.1	1.1	1.2	1.1	1.4	1.2	1.2	-	10.0
	Insurance/pension funds (as % of HH financial assets)	18.2	18.2	21.8	22.1	22.6	20.1	22.4	-	27.8
	Total assets of all insurers (% of GDP)	2.7	2.9	4.8	5.1	4.7	3.9	4.0	4.1	54.8
	Pension funds assets (% of GDP)	-	-	17.2	19.5	20.9	17.6	20.2	23.3	23.4
	1-3 4-10 <u>11-17</u> <u>18-24</u> <u>25-27</u>	Colours in	dicate perfo	ormanœ rar	nking amon	g 27 EU Mer	nber States	5.		
	¹ Annualized data.									

Oredit growth and pension funds EU data refers to the EA average.

Source: ECB, ESTAT, EIOPA, DG FISMA CMU dashboard, AMECO.

investment funds. There is also high level of cross-border activity in private equity and venture capital industry, where fund managers operate across the Baltic countries.

Latvia is currently working on a strategy for streamlining the development of start-ups, and a unique role in this strategy will be to FinTech companies. aiven The memorandum of cooperation between the Ministry of Economy and a couple of organisations representing the Latvian start-up ecosystem "On Latvian Start-up Ecosystem Development Strategy for 2022-2025" was signed in 2022. Following a legislative change to the country's stock options policy, Latvia is now ranked by Index Ventures as the most start-up-friendly country globally, and the country is striving to continue this trend. The strategy will serve as a roadmap for the next steps, both in improving the legal framework necessary and developing the support instruments (see Annex 3).

Financing the green transition

Sustainable finance in Latvia is still in the initial stages of development. The average issuance over 2021-2023 of bonds with environmental, social, and governance objectives as a share of total bond issuance was the fifth lowest in Latvia of all EU member states (¹⁰⁴). However, recently in Latvia there have been positive examples of local companies managing offer to investors sustainable and attractive investment projects. For example, Latvenergo, AST and Altum have issued green bonds, and in December 2021, the Treasury issued its first Sustainability Bond with a maturity of 8 years, raising EUR 600 mn. In May 2021, Finance Latvia Association, Financial and Capital Market Commission, Latvijas Banka, Nasdag Riga, Latvian Leasing association and Latvian Insurers Association have agreed to work together to raise public

⁽¹⁰⁴⁾ Source: AFME CMU Key Performance Indicators, Seventh Edition, November 2024.

awareness of the concept and principles of sustainability and sustainable finance, as well as to promote their implementation in business environment and everyday life.

Financial literacy

Financial literacy is still below the EU average, despite initiatives to promote financial education. Financial literacy is crucial for promoting retail investor participation in capital markets but also to familiarise SMEs with alternatives to bank financing. The Eurobarometer survey (¹⁰⁵) shows that only 11% of Latvian citizens display a high level of financial literacy, 65% a medium level, and the remaining 24% a low level, compared to the EU average of 18% for high literacy, 64% for medium, and 18% for low. This results in a composite financial literacy level of 36% in 2023, vs. an EU average of 45.5% (see Table A5.1).

⁽¹⁰⁵⁾Source: Monitoring the level of financial literacy in the EU - July 2023 - Eurobarometer survey

ANNEX 6: EFFECTIVE INSTITUTIONAL FRAMEWORK

Latvia's institutional framework influences its competitiveness. Trust in Latvia's institutions is around the EU average. Latvia has improved its legislative process and is working to increase use of evidence in policymaking. There is scope to simplify procedures and reduce administrative burdens. Latvia has a well-educated civil service, however high turnover rates and lack of digital skills are concerns. The country is working to improve the integrity framework. The justice system continues to perform efficiently.

Graph A6.1: Trust in justice, regional / local authorities and in government



Trust in government is around the EU average, achieving its highest score since 2014. However, trust in the justice system lags behind the EU average (Graph A6.1). Aspects which could increase public trust in Latvia's public administration are lower bureaucracy, and more transparency about decisions and the use of public money. Clearer information about procedures and services and increased user friendliness of the administration's digital services could also improve citizen's interactions with Latvia's public administration (¹⁰⁶). The perceived quality of government has

(106) <u>Understanding Europeans' views on reform needs -</u> <u>April 2023 - - Eurobarometer survey,</u> Country Fact Sheet. improved but remains below the EU average $(^{107})$.

Quality of legislation and regulatory simplification

Overall performance in developing and evaluating legislation has improved, getting close to the EU average (¹⁰⁸). Use of regulatory tools like ex ante impact assessment, public and reviews consultations of existing regulations is broadly similar for primary laws and subordinate regulations. Latvia has more developed impact assessment and stakeholder engagement than ex post evaluation, which is also weaker relative to the EU average. Overall, there is scope to improve methodology of impact assessments of both primary and secondary legislation, well the as as methodology, transparency, oversight and quality controls of ex post evaluations (Graph A6.2).

⁽¹⁰⁷⁾Inforegio - European Quality of Government Index

^{(&}lt;sup>108</sup>) Latvia's Fifth National Open Government Action Plan 2022-2025. Mid-term assessment. Available at: <u>link</u>





Source: OECD (2025), Regulatory Policy Outlook 2025 and Better Regulation across the European Union 2025 (forthcoming).

The recovery and resilience plan focuses on streamlining Latvia's regulatory environment, reducing bureaucracy, and making it easier to do business and innovate. In 2024, the government approved amendments to several building regulations (¹⁰⁹). The amendments aim to eliminate duplication of data in mandatory construction documents (¹¹⁰). Progress was made in leveraging technology reduce the to administrative burden to citizens and businesses of complying with tax obligations. Furthermore, Latvia has planned measures planned for calculating administrative burdens using the extended standard cost model. Other recent reforms promote the use evidence in policymaking(¹¹¹), citizen participation(¹¹²), and transparency. All draft laws and regulations to

- (110)<u>https://www.em.gov.lv/lv/jaunums/mazinas-</u> administrativo-slogu-buvniecibas-joma?utm_source
- (¹¹¹)Ministru kabinets, 2024. Valsts kancelejas Analītiskais dienests – praktisks atbalsts datos pamatotas politikas veidošana. Available at <u>link</u>

be examined by the government can be accessed online free of charge via the TAP portal (¹¹³) which enables citizens to monitor every stage of the legislative process, from drafting to adoption, and provide opportunities for public input.

Mechanisms for simplifying regulation can be further strengthened. For example, when developing or evaluating primary legislation, there is no requirement to quantify or assess administrative burdens and substantive costs of compliance of such legislation. Moreover, periodic ex post evaluation of existing regulations is not mandatory (table A6.1).

^{(&}lt;sup>109</sup>) National medium-term fiscal-structural plan Latvia 2025-2028, 15 October 2024, <u>link</u>

 ^{(&}lt;sup>112</sup>)Ministru kabinets (2024). Noteikumi nr. 639 "Sabiedrības līdzdalības kārtība attīstības plānošanas procesā". Rīgā 2024. gada 15. oktobrī (prot. Nr. 44 1. §). <u>link</u>

^{(&}lt;sup>113</sup>)The TAP portal, <u>https://tapportals.mk.gov.lv/</u>





(1) This table presents a subset of iREG indicators focusing on regulatory costs. The indicators refer to primary legislation. **Source:** OECD (2025), Regulatory Policy Outlook 2025 [https://doi.org/10.1787/56b60e39-en] and Better Regulation across the European Union 2025 (forthcoming).

The OECD product market regulation indicators show that Latvia's licensing system is slightly more burdensome than the EU-27 average and could be further aligned with best practices. For example, although the government keeps an up-to-date online inventory of all permits and licences required/issued to businesses by public bodies, there is no requirement for it to regularly review it and assess whether such licences and permits are still required or should be withdrawn. Moreover, most licences and permits issued/required by public bodies at any other level of government than central level have to be periodically renewed (see also Annex 4). Furthermore, according to a report monitoring the speeding up permit-granting procedures for renewable energy and related infrastructure projects (¹¹⁴) there is clearly scope for further aligning national practices in

Latvia with the guidance to support faster and shorter procedures for the licensing of renewable energy projects.

Social dialogue

Latvia has a well-functioning national tripartite social dialogue, although some challenges remain regarding representation and consultation. The National Council for Tripartite Cooperation (NTSP) provides the forum for national tripartite dialogue since 1993. It brings together representatives of the institutions, with the Employers' state Confederation of Latvia (LDDK) and the Free Trade Confederation of Latvia (LBAS). There are several sub-councils in the NTSP, including for budget, labour affairs, social protections and healthcare. which work effectively. Nevertheless, representation, notably of workers, is limited as there are only two national level social partners and trade union density declined to only 11.6% in 2018

⁽¹¹⁴⁾ European Commission: Directorate-General for Energy, Monitoring the implementation of the Commission recommendation and guidance on speeding up permitgranting procedures for renewable energy and related infrastructure projects – Final report, Publications Office of the European Union, 2025, link.

according to the OECD (¹¹⁵). Collective bargaining coverage also continues to decline (27.1% in 2018) (¹¹⁶). Most negotiations continue to take place at company level as collective agreements at industry level remain rare. The ESF+ supports social dialogue in the 2021–2027 programming period with around EUR 1,5 million through capacity building, informative campaigns and support for collective agreements (¹¹⁷).

Digital public services

The share of digital public services exceeds the EU average for both citizens (88.2% compared to the EU average of 79.4%) and businesses (87.2% compared to the EU average of 85.4%). While there was little change in overall performance of digital public services between 2021 and 2023, access to e-health records did improve (see Table A6.2).

Latvia has a high rate of eID use (70.2%) compared to the EU average (41.1%). The Digital Decade Strategic Roadmap for Latvia until 2030 (¹¹⁸) and Latvia's recovery and resilience plan (¹¹⁹) include specific measures for improving the digital skills of students and adults aimed at overcoming challenges for the

digital transformation of society and the labour market including public administration (¹²⁰).

The country has made progress in digitalising businesses but still needs to improve digital capabilities of SMEs (¹²¹). To tackle these issues, Latvia is using funds from its recovery and resilience plan and from cohesion policy. Key steps include setting up digital innovation hubs and providing financial support for SME digitalisation. By 2026, Latvia plans to assist entities, including SMEs, through these hubs by issuing 2 000 digital transformation roadmaps and increase funding for the adoption of AI and data analytics.

Latvia is developing the necessary infrastructure towards seamless, automated exchange of authentic documents and data across the EU. There are still additional steps to be taken to become technically ready to connect to the Once-Only Technical System, part of the EU Single Digital Gateway (¹²²). In 2019, Latvia notified the eID scheme under the elDAS Regulation (¹²³). Since legal persons in Latvia are identified through a natural person, the scheme may eventually be used for legal persons once integrations into public services are made. This means that Latvian businesses can authenticate themselves to access public services provided by other Member States, including those enabled by the Once-Only Technical System (¹²⁴).

- (¹²⁰) <u>https://digital-skills-</u> jobs.europa.eu/en/actions/national-initiatives/nationalstrategies/latvia-digital-decade-strategic-roadmap-2030
- (¹²¹)European Commission. <u>Digital Decade 2024</u>: <u>Country</u> <u>reports</u>
- (¹²²) European Commission, Once-Only Technical System Accelerometer, <u>Ec.europa.eu</u>.
- (123) European Commission, eIDAS Dashboard.
- (124) European Commission, <u>The Once Only Principle</u> System: A breakthrough for the EU's Digital Single Market

⁽¹¹⁵⁾OECD Data Explorer on Trade union density, <u>link</u>.

^{(&}lt;sup>116</sup>)OECD Data Explorer on Collective bargaining coverage, <u>link</u>.

^{(&}lt;sup>117</sup>) For an analysis of the involvement of Latvia's social partners at national level in the European Semester and the Recovery and Resilience Facility, see Eurofound (2025), <u>National-level social governance of the European</u> <u>Semester and the Recovery and Resilience Facility</u>.

^{(&}lt;sup>118</sup>)Digital Decade strategic Roadmap for Latvia 2030 <u>link</u>

⁽¹¹⁹⁾Latvia's RRP supports the digital transition with investments in the digitalisation of public administration and public services. The modified plan has further strengthened the focus on the digital transition, devoting 23% of the available funds to measures that support digital objectives (up from 21% in the original plan). link

			Latvia		⊟ ⊦ 27	Digital Decade	
						target by 2030	
		2022	2023	2024	2024	EU-27	
Digitalis	Digitalisation of public services						
1	Digital public services for citizens	87	87	88	79	100	
	Score (0 to 100)	2021	2022	2023	2023	2030	
2	Digital public services for businesses	86	86	87	85	100	
	Score (0 to 100)	2021	2022	2023	2023	2030	
3	Access to e-health records	na	79	85	79	100	
	Score (0 to 100)	2021	2022	2023	2023	2030	

Table A6.2: Key Digital Decade targets monitored through the Digital Economy and Society Index

Source: State of the Digital Decade report 2024

Civil service

Latvia continues to have a well-educated civil service. The share of public administration employees with higher education qualifications (71%) and of those pursuing adult learning (24.9% points to a relatively high-skilled workforce. Latvia also has one of the youngest public administration workforces in the EU with less than 30% of the civil servants above the age of 49 (¹²⁵). In 2024, the proportion of women in senior civil service posts was 58.7%, above the EU-27 average of 46.5% (¹²⁶).

Staff turnover is a challenge, particularly among skilled professionals and managers in public administration. This impacts institutional memory, quality and effectiveness of public policies (¹²⁷). In late 2024, the State Chancellery launched a 'vacancy bank', a virtual pool of posts unfilled for over 12 months which are available for redeployment to new tasks (¹²⁸). This came amid efforts to balance

public expenditure, including a freeze on creating new posts at national and local levels in 2025. Public sector pay increases for 2025 have been capped at 2.6% (¹²⁹).

Latvia is implementing its 2023-2027 public administration modernisation plan (¹³⁰). In 2024, the innovation lab of the State Chancellery implemented six initiatives under the recovery and resilience facility (¹³¹) to drive innovation in healthcare, justice, bio-region management and local competitiveness. Moreover, Latvia's Single Service Centre became fully operational on 1 January 2025 (¹³²). Its aim is to bring together public service provision under the Central Resources' Management System and its selfservice portal for accounting and human resources management. By 2025, under the recovery and resilience plan, training is due to be delivered to 16 000 public officials on ethics, anti-corruption and conflict of interest, and to

⁽¹²⁵⁾ Eurostat. 2025. European Union Labour Force Survey.

^{(&}lt;sup>126</sup>) European Institute for Gender Equality (EIGE), 'Gender Statistics Database', available at: <u>link</u>

⁽¹²⁷⁾ OECD (2024), OECD Economic Surveys: Latvia 2024, OECD Publishing, Paris, <u>https://doi.org/10.1787/dfeae75b-en</u>.

^{(&}lt;sup>128</sup>) Valsts kanceleja (2024). Valsts pārvaldē samazinās ilgstoši vakanto amata vietu skaitu. Available at: <u>link</u> (accessed 29/12/2024)

^{(&}lt;sup>129</sup>) Ministru kabinets (2024). Publiskajā pārvaldē 2025. gadā atlīdzības pieaugumu samazinās līdz 2,6%. Available at: <u>link</u> (accessed 29/12/2024)

⁽¹³⁰⁾ In January 2025 the Crises Management Centre was established under the supervision of the Prime Minister mandated to monitor and manage civil security risks 24/7.

^{(&}lt;sup>131</sup>)State Chancellery (2024). Sešus valsts un pašvaldību iestāžu izaicinājumus šogad risinās Valsts kancelejas Inovācijas laboratorijā. Available at: <u>link</u> (accessed 29/12/2024)

^{(&}lt;sup>132</sup>)Atveseļošanas fonda plāna Darbības kārtība, par kuru vienojas Eiropas Komisija un Latvija. Available at: <u>link</u> (accessed 29/12/2024)

20 000 public officials on customer service, leadership, public procurement, human resources management and policy planning and implementation.

Integrity

consider corruption Businesses to be widespread, despite measures being taken to mitigate corruption risks in public procurement. In Latvia, 63% of companies consider that corruption is widespread (EU average 64%), while only 20% consider that corruption is a problem when doing business (EU average 36%) (¹³³). Moreover, only 23% of companies believe that people and businesses caught for bribing a senior official are appropriately punished (EU average 31%) (¹³⁴). Corruption-related cases are investigated and prosecuted efficiently, including as regards various high-level corruption cases and foreign bribery (¹³⁵). Public procurement is an area at high risk of corruption in Latvia. 29% of companies (EU average 27%) think that corruption has prevented them from winning a public tender or a public procurement contract in practice in the last three years (¹³⁶). On 5 October 2023, amendments were adopted to align public procurement rules with EU legislation. The Latvian Ministry of Finance also published a handbook for the Implementation of Risk Management, in order to increase transparency integrity public and in procurement (¹³⁷).

Work is underway in Latvia to adopt implementing rules on lobbying and to set up а lobbying register by 2028. Implementing rules from the legislation in order to regulate the promotion of corporate interests and create an interest representation registry and declaration system, were delayed and are still under discussion. The interest representation registry and declaration system are expected to become fully operational by 1 September 2028. Their implementation will help increase transparency and ensure a level playing field for companies. The need to introduce sanctions for breaches of the law will be examined once the system is up and running.

Justice

The justice system is continuing to perform efficiently. The length of court proceedings and number of pending cases was among the lowest in the EU. The disposition time in civil and commercial cases at first instance courts has decreased slightly, from 209 days in 2022 to 204 days in 2023. The disposition time for administrative cases at first instance increased slightly, from 200 days in 2022 to 205 days in 2023. The quality of the justice system is considered to be good overall. The level of digitalisation of the justice system remains high, with digital technology being widely allowed in court proceedings and well used in courts and prosecution. In 2023, national stakeholders rated positively the usability of the judiciary's ICT systems. As regards judicial independence, no systemic deficiencies have been reported. (138)

^{(&}lt;sup>133</sup>) Flash Eurobarometer 543 on businesses' attitudes towards corruption in the EU (2024).

⁽¹³⁴⁾ Ibid.

^{(&}lt;sup>135</sup>)See the 2024 country-specific chapter for Latvia of the Rule of Law Report, pp. 12-13.

^{(&}lt;sup>136</sup>)Flash Eurobarometer 543 on businesses' attitudes towards corruption in the EU (2024).

^{(&}lt;sup>137</sup>) See the 2024 country-specific chapter for Latvia of the Rule of Law Report, p. 17.

^{(&}lt;sup>138</sup>)For more detailed analysis of the performance of the justice system in Latvia, see the upcoming 2025 EU Justice Scoreboard and the 2024 Rule of Law Report.

SUSTAINABILITY ANNEX 7: CLEAN INDUSTRY AND CLIMATE MITIGATION

Latvia faces significant challenges regarding its clean industry transition and climate mitigation: net-zero manufacturing lts capacity is limited and lacks a strong industrial policy framework, while the adoption of electric vehicles is hindered by insufficient charging infrastructure. Addressing greenhouse gas emissions from buildings appears particularly exigent. The dependence on imported critical raw materials needs diversification, and Latvia's energy efficiency and circular material use rate lag behind EU averages. This annex reviews the areas in need of urgent attention in Latvia's clean industry transition and climate mitigation, looking at different dimensions.

Strategic autonomy and technology for the green transition

Net zero industry

Latvia's net-zero manufacturing capacity remains very modest, focusing on wind and hydrogen (¹³⁹). The main relevant production facility is Naco Technologies' plant in Riga, which produces nano coatings for electrolysers. Latvia holds a competitive edge in the production and export of grid technology mainly switchgears, components, circuit electronic control breakers and panels. Additionally, Latvian industry is competitive when it comes to the production and export of steel structures are used in wind turbines. The absence of industrial policy and a dedicated regulatory framework for net-zero industry means there are few signals to support the scale up of manufacturing in net-zero industry.

Given the dominance of road transport in Latvia and the country's low EV market

share, there is considerable potential to reduce greenhouse gas emissions in the sector. In Latvia, most transport goes via road, with cars accounting for the largest share of both passenger transport (74.8%) and freight traffic (84%).

Despite the growing interest in electric vehicles (EVs), their market share remains comparatively low, with only 6.4% of newly registered passenger cars being battery electric vehicles (BEVs) in 2024. This figure is significantly lower than the EU average of 14.5% (¹⁴⁰). Moreover, the share of BEVs in the passenger car fleet was 0.7% in 2024 (EU average: 2.2%). The limited adoption of EVs in Latvia can partly be attributed to the country's insufficient charging infrastructure. Latvia has one of the lowest charging capacities in the EU, both per kilometre of road and per inhabitant. Although the number of publicly accessible charging points has doubled since 2023, the absolute number remains very low (1 for every 5 cars, or 1 on every 1 300 km of highway). This lack of charging infrastructure serves as a significant barrier to the widespread adoption of EVs(¹⁴¹).

Critical raw materials

When it comes to critical raw materials, market operators are dependent on imports, but diversification is high. Latvian industry imports the vast majority of raw materials it needs as production inputs. In 2023, roughly 28.6% of direct material input in the economy was imported (EU average of 22%)(¹⁴²). Especially, coking coal, copper, titanium and borates are imported, mainly from non-EU countries in Europe and Asia. Major trade

^{(&}lt;sup>139</sup>)European Commission: Directorate-General for Energy, The net-zero manufacturing industry landscape across the Member 2025, <u>https://data.europa.eu/doi/10.2833/2181110</u>

^{(140) &}lt;u>Statistics | Eurostat</u>

⁽¹⁴¹⁾ Latvia | European Alternative Fuels Observatory.

^{(&}lt;sup>142</sup>) <u>Statistics Eurostat</u>.

partners are Turkey, Kazakhstan as well as Russia. Especially the latter remains a threat to Latvia's economic security, as Russia is its sole supplier of titanium(¹⁴³). Here, the Latvian economy can benefit from further diversification. Nevertheless, Latvia's import concentration index is comparably low with 0.17 (EU average 0.22).

Climate mitigation

Industry decarbonisation

Latvia's manufacturing industry is making progress in reducing its greenhouse gas emissions. With 11%, industry's share of total greenhouse gas emissions in Latvia is among the lowest in the EU (144). In 2022, industrial production in Latvia emitted 360 g CO2eg of greenhouse gases per euro of gross value added (GVA), one third higher than the EU average (270 g). Between 2017 and 2022, the emissions intensity of Latvia's industry declined by 11%, less than in the EU overall (20%). A part of emissions major in Latvia's manufacturing, 59% in 2023, is related to processes and product use, and only 41% relate to energy use; in the EU as a whole, the shares are the opposite, 57 to 43.

Latvia's manufacturing sector is benefitting from cleaner energy supplies, but its energy efficiency lags behind the EU, and its process-related emissions have increased. Between 2017 and 2022, the energy-related emissions intensity of Latvia's manufacturing

(143)<u>RMIS - Country Profiles</u>.

industry declined by 14% since 2017, slightly less than in the EU overall (16%) (¹⁴⁵). In the same period, the share of electricity and renewables in final energy consumption in manufacturing increased by 8 percentage points, to 74% in 2022, the third highest share in the EU. In parallel, the energy intensity of manufacturing in Latvia has slightly increased, to 2.9 GWh per euro of GVA, and it remains among the highest in the EU. Between 2017 and 2022, the process and product use-related emissions intensity of Latvian manufacturing increased by 7%, in contrast with a decline by 23% in the EU overall.





Among Latvia's energy-intensive industries, the manufacture of non-metallic mineral products shows elevated greenhouse emissions intensity. Energy-intensive industries (¹⁴⁶) account for 11% of Latvia's

⁽¹⁴⁴⁾ In 2023. Manufacturing includes all divisions of the "C" section of the NACE Rev. 2 statistical classification of economic activities. In the remainder of this section, unless indicated otherwise, data on manufacturing refer to the divisions of the NACE section C excluding division C19 (manufacture of coke and refined petroleum products), and the year 2022. The source of all data in this section is Eurostat; data following the UNFCCC Common Reporting Framework (CRF) are from the European Environment Agency (EEA), republished by Eurostat.

^{(&}lt;sup>145</sup>)For the GHG emissions intensity of GVA related to energy use and industrial processes and product use respectively, GHG emissions are from inventory data in line with the UNFCCC Common Reporting Format (CRF), notably referring to the source sectors CRF1.A.2 – fuel combustion in manufacturing industries and construction and CRF2 – industrial processes and product use. The CRF1.A.2 data broadly correspond to the NACE C and E sectors, excluding C-19. GVA data (in the denominator for both intensities) are aligned with this sectoral coverage. Therefore, they are not fully consistent with the data referred to in other part of this section.

⁽¹⁴⁶⁾ Notably, the manufacture of paper and paper products (NACE division C17), of chemicals and chemical products (C20), "other" non-metallic mineral products (C23; this division includes manufacturing activities related to a single substance of mineral origin, such as glass, ceramic products, tiles, and cement and plaster), and basic

manufacturing gross value added (2022). Among these, the manufacture of non-metallic mineral products had a relatively high emissions intensity of production, 3.9 kg CO2eg/€ of GVA, above the EU value of 2.2 kg. In the other sectors, emissions intensity is comparatively low. The manufacture of nonmetallic minerals dominates Latvia's energy--intensive industries together, providing 6% of GVA in the manufacturing sector. After a peak in 2022, production in energy-intensive sectors declined in 2023 has more than in manufacturing overall (see graph A7.2).

Latvia has put in place some specific policies decarbonisation support the to of industries. Examples include its Green Industry Fund, which helps companies to adopt energyefficient technologies, renewable energy sources and sustainable materials (¹⁴⁷). Further efforts are needed to accelerate decarbonisation.

Graph A7.2: Manufacturing industry production: total and selected sectors, index (2021 = 100), 2017-2023



Source: Eurostat

metals (C24). To date, these industries are energyintensive – i.e. consuming much energy both on site and/or in the form of purchased electricity – and greenhouse gas emissions intensive, in various combinations.

(147)Notably under the EEA-Norvegian grants project, see <u>EEA</u> <u>and Norwegian financial instruments</u>. Reduction of emissions in the effort sharing sectors

Latvia is projected to reach its 2030 effort sharing target if it adopts and implements the planned additional climate mitigation measures (¹⁴⁸). In 2023, GHG from Latvia's effort sharing sectors are expected to have been 4% below those of 2005. By 2030, current policies are projected to reduce them by 12.7% relative to 2005. Additional policies considered in Latvia's final updated NECP are projected to entail reductions by a further 7.8 percentage points. Hence Latvia is projected to overachieve its effort sharing target, -17%, by 3.5 percentage points (¹⁴⁹) once those measures are adopted and implemented.

Swift action on decarbonising buildings appears particularly needed in Latvia. Between 2005 and 2023, greenhouse gas emissions from buildings decreased by 10% in Latvia, much less than by the 33% seen in the EU overall. Speeding up climate mitigation in this sector would help protect households and businesses in Latvia from the impact of the forthcoming carbon price.

^{(&}lt;sup>148</sup>) The national greenhouse gas emission reduction target is set out in Regulation (EU) 2023/857 (the Effort Sharing Regulation). It applies jointly to buildings (heating and cooling); road transport, agriculture; waste; and small industry (known as the effort sharing sectors).

 ⁽¹⁴⁹⁾ The effort sharing emissions for 2023 are based on approximated inventory data. The final data will be established in 2027 after a comprehensive review.
Projections on the impact of current policies ("with existing measures", WEM) and additional policies ("with additional measures", WAM) as per Latvia's final updated NECP.





Source: European Environment Agency

Sustainable industry

Circular economy transition

Latvia faces significant challenges in transitioning economy, to а circular requiring urgent action to boost its circular material use rate, fully implement its policy framework and adopt upstream circularity measures. In 2023, Latvia's circular material use rate (5%) was less than half the EU average of 11.8% and far behind the EU leaders. Resource productivity, too, was well below the EU average in 2023, with EUR 1.26 per kg of material consumed vs. EUR 2.23 per kg as the EU average. Latvia's resource productivity has been slightly improving since 2020. The 2021action plan 'Towards 2027 а Circular Economy' (150) adopted in 2020 makes a positive step towards circularity and shifting consumption and production patterns. However, it remains guite general lacking quantified concrete actions and targets and clear strategies to ensure these initiatives extend beyond niche activities and are effectively integrated into the broader economy and society. Despite progress with

initiatives like a beverage packaging deposit and updates to green public system procurement, weaknesses persist in separate collection, notably bio-waste collection, municipal waste recycling and high reliance on landfilling. There is a need to raise public awareness about the circular economy and promote the use of reusable, environmentally friendly materials in production. This includes adopting "safe by design" technological solutions, implementing eco-design principles, developing innovative circular business models with eco-efficient technologies and ecopromoting innovations, and industrial symbiosis where industries and businesses exchange waste materials, energy or byproducts to improve their resource efficiency and reduce environmental impact.

Latvia is struggling with waste management and has a significantly higher material footprint per capita compared to the EU average. Although with 464 kg in 2022, Latvia produces less waste per capita than the EU average, 513 kg, waste generation increased by 14% since 2018. With a recycling rate of 50.8%, Latvia has improved its municipal waste recycling, but it is at risk of falling short of the 2025 reuse and recycling targets and the 2035 landfill reduction goal of 10%, with 44% of municipal waste still being landfilled. In 2022, Latvia's recycling rate for plastic packaging of 47% was above the EU average of 41%. In 2022, 87% of construction and demolition waste was recycled, excluding backfilling, above the EU average of 79.8%. At the same time, the material footprint of 19.6 tonnes per capita is considerably higher that the EU average of 14 tonnes per person. In 2024, Latvia introduced bio-waste collection, providing residents with separate bio-waste containers, but not yet sufficiently, and local governments continue to work on this issue. Additionally, as of July 2024, Latvia introduced an extended producer responsibility system for

^{(&}lt;sup>150</sup>)Cabinet Regulations No. 489, *Par Rīcības plānu pārejai uz aprites ekonomiku 2020.-2027. Gadam*, <u>Link</u>.
new and used textile products (¹⁵¹), thus contributing to their recycling and promoting sustainable practices.

investment circularity Current in the transition has been insufficient. lt is estimated (¹⁵²) that Latvia will need additional investment worth at least EUR 67 million per year for the circular economy transition, including waste management. Of the circular economy gap, EUR 15 million relates to recent initiatives, such as eco-design for sustainable products, packaging and packaging waste, labelling and digital tools, critical raw materials recycling, as well as measures proposed under the amended Waste Framework Directive. The remainder (EUR 43 million) covers further investment needs to unlock Latvia's circular economy potential.

Zero pollution in industry

Air emissions intensity from industry in Latvia is below the EU average and Latvia meets its emissions reduction commitments for all air pollutants except ammonia. Currently, the emissions reduction commitments under the 2020-2029 National Air Pollution Control Programme are not fully met, while the commitments for the year 2030 are projected to be all met. In 2024, Latvia met its emissions reduction commitments for air pollutants NO_x, non-methane volatile organic compounds, sulphur dioxide and PM_{2.5}, but did not meet the ammonia reduction commitment. The main reason for not meeting ammonia limit values can be attributed to agricultural practices, particularly pollution from livestock farming and the use of fertilisers.

⁽¹⁵¹⁾ Cabinet Regulations No. 359 dd., Noteikumi par ražotāja paplašinātās atbildības sistēmas izveidi un piemērošanu tekstilizstrādājumiem, <u>Link</u>.

^{(&}lt;sup>152</sup>)European Commission, DG Environment, *Environmental investment needs* & gaps assessment programme, 2025 update. Expressed in 2022 prices.

Table A7.1: Key clean industry and climate mitigation indicators: Latvia

Strategic autonomy and technology for the green transition		l	atvia						EU	-27
Net zero industry										
Operational manufacturing capacity 2023 - Solar PV (c: cell, w: wafer, m: module), MW - - Wind (b: blade, t: turbine, n: nacelle), MW -	- Electrolyzer, MW - - battery, MWh -									
Automotive industry transformation Motorisation rate (passenger cars per 1000 inhabitants), % New zero-emission vehides, electricity motor, %	2017 356 024	2018 369 0.45	2019 381 0.63	2020 390 2.56	2021 404 328	2022 409 6.40	2023 418 8.83	۲ ۲	2018 539 1.03	2021 561 8.96
Oritical raw materials	2017	2018	2019	2020	2021	2022	2023		2018	2021
Material import dependency, %		32.9	31.5	32.0	31.4	31.7	28.6	2	24.2	22.6
Climate mitigation			Latvi	a				Trend	Ð	-27
Industry decarbonisation	2017	2018	2019	2020	2021	2022	2023		2017	2022
G-Gemissions intensity of manufacturing production, kg/€	0.41	0.44	0.42	0.39	0.35	0.36		2	0.34	027
Share of energy-related emissions in industrial G-IGemissions	52.6	53.5	54.1	56.8	56.8	57.2	58.8	7	44.8	42.5
Energy-related GHG emissions intensity of manufacturing and construction, kg€	1432	149.2	131.8	130.7	127.4	123.3	-	1	158.4	132.9
Share of electricity and renewables in final energy consumption in manufacturing, %	65.4	64.0	66.7	68.7	69.8	73.6	72.8	7	43.3	44.2
Energy intensity of manufacturing, GWV€	2.86	3.03	2.85	2.88	2.69	2.89	2.93	7	1.29	1.09
GHGemissions intensity of production in sector [], kg/€ - paper and paper products (NACEC 17) - chemicals and chemical products (NACE C20) - other non-metallic mineral products (NACE C23) - basic metals (NACE C24)	0.17 0.56 3.40 1.34	0.15 0.43 4.06 0.18	0.13 0.36 3.87 0.08	0.10 0.24 4.03 0.06	0.14 0.23 3.27 0.13	0.14 0.20 3.89 0.08	- - -		0.73 1.25 2.53 2.79	0.68 1.26 2.24 3.49
Reduction of effort sharing emissions		2018	2019	2020	2021	2022	2023		2018	2023
GHGemission reductions relative to base year, % - domestic road transport - buildings		7.7 -6.7	7.1 -8.3	0.0 -7.6	1.0 3.8 -42	-1.9 1.0 -6.0	-4.0 0.1 -10.1	31 21	1.4 21.4	5.2 32.9
	2005				2021	2022	2023	Target	WEW	WAM
Effort sharing: G-Gemissions, Mt; target, gap, %	8.6				8.7	8.4	8.3	-17.0	-4.3	3.5
Sustainable industry			Latvi	a				Trend	Đ	-27
Circular economy transition		2018	2019	2020	2021	2022	2023		2018	2021
Material footprint, tonnes per person		17.2	17.3	17.0	18.7	19.3	19.6	7	14.7	15.0
Groular material use rate, % Resource productivity, €/kg		4.7 1.0	4.8 1.1	52 1.1	5.0 1.1	4.5 1.3	5.0 1.3	2	11.6 2.1	11.1 2.3
Zero pollution industry Years of life lost due to RV2.5, per 100,000 inhabitants Air pollution damage cost intensity, per thousand € of G/A Water pollution intensity, kg weighted by human factors per bn € G/A		808	567	457	720 9.6	645 0.1	-	<i>L</i>	702	571 27.5 0.9

Source: Net zero industry: European Commission: <u>The net-zero manufacturing industry landscape across Member</u> <u>States: final report</u>, 2025. **Automotive industry transformation:** Eurostat. **Critical raw materials:** Eurostat. **Climate mitigation:** See footnotes in the "climate mitigation" section; reduction of effort sharing emissions: <u>EEA greenhouse</u> <u>gases data viewer</u>; European Commission, <u>Climate Action Progress Report</u>, 2024. **Sustainable industry:** Years of life lost due to PM2.5: Eurostat and EEA, <u>Harm to human health from air pollution in Europe: burden of disease status</u>, 2024. Air pollution damage: EEA, <u>EU large industry air pollution damage costs intensity</u>, 2024. Emissions covered: As, benzene, Cd, Cr, Hg, NH3, Ni, NMVOC, NOX, Pb, dioxins, PM10, PAH, SOX. Water pollution intensity: EEA, <u>EU large industry water</u> pollution intensity, 2024. Releases into water covered from cadmium, lead, mercury, nickel. Other indicators: Eurostat.

ANNEX 8: AFFORDABLE ENERGY TRANSITION

This annex outlines the progress made and the ongoing challenges faced in enhancing energy competitiveness and affordability, while advancing the transition to net zero. It examines the measures and targets proposed in the final updated national energy and climate plans (NECPs) for 2030.

Latvia is progressing towards clean energy production, building on its already extensively decarbonised electricity mix. The country has progressed notably in solar power and development has completed the synchronisation project. Challenges remain regarding high energy prices, grid capacity and permitting length.

Energy prices and costs

Graph A8.1: **Retail energy price components for household and non-household consumers, 2024**



(i) For household consumers, consumption band is DC for electricity and D2 for gas. Taxes and levies are shown including VAT.

(ii) For non-household consumers, consumption band is ID for electricity and I4 for gas. Taxes and levies are shown excluding VAT and recoverable charges, as these are typically recovered by businesses.

Source: Eurostat

Latvian retail energy prices decreased in 2024, both for household and nonhousehold consumers, and remained below EU-average levels. Prices for household consumers decreased by 14% for electricity and 32% for gas, respectively lower to the EU average by 10% and 28%. Electricity prices for non-household consumers were 35% below the EU average and supported by a low taxes and levies component amounting to 1.4% of the total price, compared to an EU average of 15.4%. The same trend is observed in gas prices for non-household consumers, with a taxes and levies component representing only 2.3% of the total price, 9.3pp below the EU-average for this component, supporting a price lower to the EU-average by 7.7%.

Graph A8.2: Monthly average day-ahead wholesale electricity prices and European benchmark natural gas prices (Dutch TTF)



(i) the Title Transfer Facility (TTF) is a virtual trading point for natural gas in the Netherlands. It serves as the primary benchmark for European natural gas prices.
(ii) Baltics and CWE respectively provide average prices in the Baltic market (Estonia, Latvia, and Lithuania) and central-western European market (Belgium, France, Germany, Luxembourg, the Netherlands, and Austria).
Source: S&P Platts and ENTSO-E

With an average of 87.43 EUR/MWh in 2024 (¹⁵³), on a par with the other Baltic states, Latvia faced wholesale electricity prices above the EU average (84.7 EUR/MWh). While prices in Latvia declined early in the year amid falling natural gas costs, they surged during the spring/summer, diverging levels registered in from the Central Western European (CWE) markets. Prolonged and warmer summer heatwaves in the region led to higher electricity consumption (+5% in June-August 2024 vs same period in 2023), while a strained net

⁽¹⁵³⁾Fraunhofer (ENTSO-E data).

importing position and limited non-fossil flexibility exacerbated the supply-demand gap. This gap was mainly covered by increased hydro output and costly natural gas-fired generation (respectively +45% (¹⁵⁴) and +13% in June-August 2024 vs same period in 2023), ramping up especially during peak demand hours. Consequently, and more frequently in 2023, these conditions drove concentrated price spikes in the evening hours (18h-21h), when solar output declined, and demand remained high. On the other hand, average daytime hourly prices throughout the year were lower compared to 2023, likely owing to the penetration of newly installed solar power in Latvia, which generated 0.4 TWh in 2024, as well as the uptake of solar output in both Estonia and Lithuania (+20% and +103% in 2024) (¹⁵⁵). Prices in the Baltics then stabilised in the winter, supported by stronger wind generation compared to 2023(¹⁵⁶), particularly from Lithuania (157), while Central Western European markets faced strong price spikes due to considerable fluctuations in the generation of low renewables.

Flexibility and electricity grids

То strengthen the resilience of the electricity system, the Baltic states have successfully, of 9 February 2025, as connected to the Central Europe synchronous area and desynchronised from the BRELL system. In addition to the support received under the Connecting Europe Facility (CEF) for Energy, the synchronisation support activities are also supported under the Latvian recovery and resilience plan. Latvia is expected

to carry out some major grid reinforcements, including the refurbishment of the existing electricity interconnection between Latvia and Estonia in the coming years. Furthermore, plans for 2040 include the implementation of a Latvia-Sweden and a Baltic-German electricity interconnection project. Latvia is part of the Baltic (¹⁵⁸) capacity calculation region (CCR). Member States should ensure that a minimum of 70% of technical cross-border capacity is available for trading. The general trend in this CCR is that direct current bidding zone borders generally meet the 70% capacity requirement, reductions only occurring with during maintenance of individual direct current links. The synchronisation, as well as the planned reinforcements of the national grid, will make it possible to boost the country's cross-border trade capacity.

Latvia's energy infrastructure (generation, distribution, transmission) permitting system involves a structured and integrated approach throughout the process. Latvia has recently dedicated and set up a one-stop-shop for energy infrastructure permitting. However, the permitting procedure is not subject to any set maximum time limits and could be significantly delayed by the environmental impact assessment.

The connection of new large renewable generation facilities remains blocked due to virtual overcapacity of the grid. The Latvian electricity transmission system operator Augstsprieguma Tikls has refrained from issuing new grid connection permits since July 2023. Under the REPowerEU chapter of its recovery and resilience plan, Latvia set out to prepare a regulatory framework which would make it possible for existing electricity networks to be used more effectively in order to support the connection of additional renewable generation facilities. Moreover,

⁽¹⁵⁴⁾ENTSO-E.

^{(&}lt;sup>155</sup>)Fraunhofer (ENTSO-E data).

^{(&}lt;sup>156</sup>) In November-December 2024, electricity generation from wind power amounted to 0.07 TWh in Latvia (+73% vs same period in 2023), 0.37 TWh in Estonia (+210%) and 0.8 TWh in Lithuania (+53%).

^{(&}lt;sup>157</sup>) In November-December 2024, Latvia's net imports increased by +195% compared to the same period in 2023, due to higher imports from Lithuania.

^{(&}lt;sup>158</sup>) A CCR lays down the set of bidding zone borders among which the tasks of capacity calculation are coordinated by transmission system operators. Finland, Sweden, Estonia, Latvia, Lithuania and Poland are part of the Baltic CCR.

Latvia committed to realising significant investments to upgrade the capacity and flexibility of its electricity grid. Latvia is also about to adopt its electricity market law, in particular to address grid overbooking.

Latvia is taking steps to support non-fossil flexibility, including promoting electricity storage and expanding renewable energy capacities through the deployment of wind and solar power.

Despite significant regulatory action taken in the areas of self-consumption and energy communities, improvements in the legal framework governing demand-response and storage would be beneficial. Rules for aggregation would be useful to allow for demand-side response (DSR) and storage to participate in day-ahead and intraday markets, as well as ancillary services. On the other hand, Latvia took significant regulatory steps in the areas of self-consumption and electricity sharing in 2024, by amending the Electricity Market Law and the norms on the trade in and use of electricity. Additional steps were also taken in the area of energy communities, through the adoption of the Regulation on rules for the registration and operation of energy communities. These reform aspects were carried out as part of the 'Transforming the Energy Sector' reform package of Latvia's recovery and resilience plan. Latvia has also launched the first small-scale demonstration projects for energy communities within the municipality of Marupe (¹⁵⁹).

Additional efforts would be beneficial empower consumers to actively participate in the energy market. In Latvia – while access to dynamic-price contracts is ensured – the share of fixed-price contracts for electricity held by households increased from about 65%

(¹⁵⁹)<u>https://www.interregeurope.eu/good-practices/first-</u> <u>energy-communities-in-latvia-small-scale-demonstration-</u> <u>projects-at-marupe-municipality</u>

in 2022 to about 85% in 2023 (160). Only 15% of households had a dynamic-price contract in accordance with Directive (EU) 2019/944. The share of dynamic-price contracts in the meaning of the Directive remains significantly lower than the share of fixed-price electricity contracts among household customers. This increase of fixed-price contracts for households of about 20 pps compared to 2022 may be correlated to the share of renewable energy in the different national wholesale electricity markets (approx. 8% in Latvia) (¹⁶¹). Switching rates in electricity contracts decreased slightly from around 6% to about 4% for household customers and from around 29% to about 27% for non-household customers in 2023(¹⁶²). The coverage of households with smart meters increased slightly from 98% to 99% compared to 2022(¹⁶³).

In 2023, electricity accounted for 14.3% of Latvia's final energy consumption, considerably below the EU average of 22.9%, and this share has remained largely stagnant in the last decade (164). When it comes to households, electricity accounts for 13.2% of final energy consumption, while in industry it represents 16.3% (see also Annex 9). For the transport sector, this share remains negligible at 0.9%. Further progress in electrification across sectors is required for cost effectively decarbonising the economy and bringing the benefits of affordable renewable generation to consumers.

^{(&}lt;sup>160</sup><u>https://www.acer.europa.eu/sites/default/files/documents/</u> <u>Publications/ACER-CEER_2024_MMR_Retail.pdf</u>

^{(161)&}lt;u>https://www.acer.europa.eu/sites/default/files/documents/</u> Publications/ACER-CEER_2024_MMR_Retail.pdf

⁽¹⁶²⁾ Idem

^{(&}lt;sup>163</sup>)ldem

^{(&}lt;sup>164</sup>)CAGR (compound annual growth rate) of -0.6% between 2013 and 2023 and minimum/maximum share of 14.2% and 15.1%, respectively.

Renewables and long-term contracts

Renewable sources in Latvia represented 78% of electricity generation over 2024, compared to 47% in the EU overall (¹⁶⁵).

The total renewable energy capacity in Latvia in 2024 stood at 2312 MW, up 6.8% from 2023. Latvia increased its long-term ambition for deployment of renewable energy. In other words, it increased its target contribution for renewable energy to 61% for 2030 (share of gross final energy consumption) in its final updated national energy and climate plan (up from the 57% in the draft NECP), which is in line with the level based on the Governance Regulation. It is important to ensure that efforts across sectors are coordinated in order to achieve the more ambitious goals for 2030 and implement the requirements of the revised Renewable Energy Directive, which is due to be transposed by May 2025.

Graph A8.3: Latvia's installed renewable capacity (left) and electricity generation mix (right)



biofuels, liquid biofuels, and biogas. Source: IRENA, Ember

Some efforts have been taken in recent years to accelerate the deployment of solar and wind energy. In 2024, Latvia recorded an steep increase in the installed capacity for solar (+46%, from 319 MW to 466MW) but not in wind power (128 MW). However, these capacities still remain significantly below the levels installed in Estonia and Lithuania. Transport is an area where considerable efforts are still needed given the low level of renewables uptake and high greenhouse gas emissions intensity in this sector. The new Transport Energy Law, which still awaits its adoption in 2025, would pave the way for the action needed to decarbonise the sector.

On permitting, the Latvian framework is moderately aligned with the Commission's **Recommendation.** The government introduced legislation enabling a one-stop shop to centrally streamline renewable energy installations. This includes reducing the number of institutions involved in permit-granting, cross-border cooperation launching with neighbouring and countries, revisiting exclusion zone regulations to improve land access for renewable energy projects. Implementation remains to be seen, while there is room for further additionally, improvement to shorten the permit-granting procedure for renewable energy sources, especially for larger onshore wind and solar installations. This can be achieved, for instance, through simplified procedures for energy communities as well as authorities jointly respecting deadlines and extensions, and taking into consideration the guidance on speeding up permit-granting procedures.

Energy efficiency

In 2023, there was a slowdown in the energy efficiency gains achieved in Latvia. In 2023, primary energy consumption (PEC) decreased by a mere 0.1% to 4.27 Mtoe, while final energy consumption (FEC) decreased only by 0.8% to 3.9 Mtoe. Compared to 2022, FEC increased in transport by 2.4% and in industry by 1.6%, while it decreased in residential by 3.3% and in services by 5.4%. According to the recast Directive, Energy Efficiency Latvia is encouraged to reach a PEC of 3.8 Mtoe and an FEC of 3.46 Mtoe by 2030. In its NECP, Latvia

⁽¹⁶⁵⁾Yearly electricity data, Ember.

aims for a slightly higher target, with 3.85 Mtoe for FEC.

energy In implementing the savings obligation for the period 2021-2030, Latvia has chosen alternative measures to the energy efficiency obligation scheme to achieve the targets. However, the information Latvian final updated NECP in the is incomplete, making it impossible possible to assess the adequacy of the planned measures against the achievement of the required amount of cumulative end-use energy savings by 2030. Furthermore, Latvia has not notified the Commission of its comprehensive assessment of heating and cooling identifying the potential for the application of highefficiency cogeneration and efficient district heating and cooling as required by Article 25(1) of Directive (EU) 2023/1791.

Latvia has the potential to make more energy efficiency improvements, namely through leveraging additional private funding. Latvia's national financing framework mobilising investments in energy efficiency is mostly composed of grants and different financial instruments, including in the form of technical assistance and guarantees. These schemes largely target the building sector, all main segments covering such as commercial, and residential. public For instance, in 2024 Latvia continued to implement not only the investment schemes supporting the refurbishment of municipal and educational buildings, but also the grant schemes promoting energy efficiency improvements and the installation of renewable electricity generation in private residential buildings. Most of the energy efficiency schemes in the country are (co)financed by the Recovery and Resilience Facility and by EU cohesion funds. Additional private funding could be leveraged, in particular by deploying dedicated financial instruments energy efficiency for and supporting the development of the energy services sector as a key market-enabler for energy efficiency improvements.

Despite the progress made in building renovations, additional efforts would be needed for Latvia to achieve its goals set out the long-term renovation strategy. in Latvia's efforts in the residential sector to achieve a meaningful contribution to its 2030 reduction target for energy consumption by buildings are on the right track, as residential final energy consumption fell by around 13% in 2022 compared to 2018. Latvia has, for example, introduced regulatory adjustment with a view to facilitating energy efficiency renovations in multi-apartment buildings. However, greater efforts will be needed to implement the national long-term renovation strategy, i.e. achieve a reduction of 23% by 2030. Latvia's long-term renovation strategy is to achieve the renovation of 30% of multiapartment buildings by 2030. To facilitate this, a new support programme worth EUR 171 million will be available in 2025 to implement energy efficiency measures in multi-apartment residential buildings, as well as EUR 147 million of support from the ERDF. In 2022, heating and cooling represented 83% of the country's residential final energy consumption. There are approximately 400 000 households - slightly below half of total households - using gas to heat their homes, while the heat pump market remains limited.

Security of supply and diversification

Latvia has made significant efforts to diversify energy imports, notably by fully cutting its dependence on Russian energy, natural gas, petrol and electricity. However, Latvia's energy mix saw little change in 2023 compared to 2022, with fossil fuels still making up more than half of the country's energy consumption. Oil accounted for 36.8% and natural gas 15.9% of gross inland consumption(¹⁶⁶), while renewables (and

⁽¹⁶⁶⁾ Electricity and heat are excluded to avoid doublecounting, focusing on primary energy sources

biofuels) maintained a considerable share $(45.8)\%(^{167})$.

Fossil fuel subsidies

In 2023, environmentally harmful (¹⁶⁸) fossil fuel subsidies without a planned phase-out before 2030 represented 0.32%(¹⁶⁹) of Latvia's GDP(¹⁷⁰), below the EU weighted average of 0.49%. Tax measures accounted for 81% of this volume, while the remaining share were income/price support measures. However, Latvia's 2023 Effective Carbon Rate (¹⁷¹) averaged EUR 62.15 per tonne of CO₂, below the EU weighted mean of EUR 84.80(¹⁷²).

(¹⁶⁷)Gross inland consumption (Eurostat).

(¹⁶⁸) Direct fossil fuel subsidies that incentivise maintaining or increasing in the availability of fossil fuels and/or use of fossil fuels

(170)2023 Gross Domestic Product at market prices, Eurostat

- (¹⁷¹) The Effective Carbon Rate is the sum of carbon taxes, ETS permit prices and fuel excise taxes, representing the aggregate effective carbon rate paid on emissions.
- (172)OECD (2024), Pricing Greenhouse Gas Emissions 2024

⁽¹⁶⁹⁾ Numerator is based on volumes disclosed by the Latvian authorities via the 2025 NECPR reporting. For all Member States, it includes public R&D expenditures for fossil fuels as reported by the IEA (Energy Technology RD&D Budgets) and excludes, for methodological consistency, excise tax exemption on kerosene consumed in intra-EU27 air traffic.

Table A8.1: Key Energy Indicators

		Latvia	9		EU			
	2021	2022	2023	2024	2021	2022	2023	2024
Household consumer - Electricity retail price (EUR/KWh)	0.1628	0.2632	0.3040	0.2617	0.2314	0.2649	0.2877	0.2879
Energy & supply [%]	44.5%	60.3%	58.7%	49.7%	36.6%	54.3%	55.6%	47.8%
Network costs	29.2%	19.7%	23.8%	32.6%	26.7%	25.3%	24.8%	27.2%
Taxes and levies including VAT	26.3%	20.0%	17.5%	17.7%	36.7%	20.3%	19.6%	25.0%
VAT	17.4%	17.4%	17.4%	17.3%	14.5%	13.4%	13.8%	14.6%
Household consumer - Gas retail price	0.0351	0.0977	0.1288	0.0880	0.0684	0.0948	0.1121	0.1128
Energy & supply	47.0%	71.4%	70.7%	59.0%	43.7%	61.0%	64.5%	53.9%
Network costs	30.8%	11.4%	10.3%	21.4%	22.5%	17.3%	17.1%	18.3%
Taxes and levies including VAT	22.2%	17.2%	18.9%	19.7%	33.8%	21.7%	18.4%	27.8%
Non-bousebold consumer - Electricity retail price	0 1052	0 1658	0 1351	0 1222	0 12/2	0 1995	0 1071	0 1661
Energy & supply	52.9%	65.7%	71 1%	67.7%	43.0%	66 5%	63.0%	55.8%
Network costs	19.2%	12.1%	10.1%	13.9%	15.8%	10.7%	11.9%	15.5%
Taxes and levies excluding VAT	12.8%	5.9%	1.0%	1.4%	30.4%	9.9%	11.2%	15.4%
Non-household consumer - Gas retail price	0.0234	0.0877	0.0781	0.0480	0.0328	0.0722	0.0672	0.0517
Energy & supply	64.4%	77.5%	75.7%	69.7%	66.2%	77.3%	77.3%	68.7%
Network costs	14.9%	4.2%	5.8%	11.0%	7.7%	3.8%	5.3%	7.1%
Taxes and levies excluding VAT	4.7%	1.4%	1.4%	2.3%	12.5%	6.1%	7.3%	11.6%
Wholesale electrity price (EUR/MWh)	88.6	225.9	94.1	87.2	111.0	233.2	99.1	84.7
Dutch TTF (EUR/MWh)	n/a	n/a	n/a	n/a	46.9	123.1	40.5	34.4
	2017	2018	2019	2020	2021	2022	2023	2024
Gross Electricity Production (GWh)	7 531	6 725	6 438	5 725	5 846	5 031	6 388	-
Combustible Fuels	3 000	4 170	4 174	2 940	2 990	2 016	2 083	-
Nuclear	-	-	-	-	-	-	-	-
Hydro	4 381	2 432	2 108	2 603	2 708	2 750	3 794	-
Wind	150	122	154	177	141	190	271	-
Solar	0	1	3	5	7	75	239	-
Geothermal	-	-	-	-	-	-	-	-
Other Sources	-	-	-	-	-	-	-	
Gross Electricity Production [%]	20.8%	62.0%	64.99/	F1 40/	F1 10/	40.19/	22.6%	
Nuclear	39.8%	0.0%	04.8%	51.4%	51.1%	40.1%	52.0%	-
Hydro	58.2%	36.2%	22.7%	45.5%	46.3%	54.7%	50.0%	
Wind	2.0%	1.8%	2 4%	3.1%	2 4%	3.8%	4 2%	
Solar	0.0%	0.0%	0.0%	0.1%	0.1%	1.5%	3.7%	
Geothermal	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	-
Other Sources	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	-
Net Imports of Electricity (GWh)	-64	909	1 118	1 626	1 773	2 312	804	-
As a % of electricity available for final consumption	-1.0%	13.6%	16.8%	24.3%	25.6%	34.2%	12.3%	-
Electricity Interconnection [%]	45.3%	46.1%	53.9%	42.1%	47.2%	82.4%	69.4%	67.0%
Share of renewable energy consumption - by sector [%]								
Electricity	54.4%	53.5%	53.4%	53.4%	51.4%	53.5%	54.3%	-
Heating and cooling	54.6%	55.4%	57.7%	57.1%	57.4%	61.0%	61.4%	-
Transport	2.3%	4.7%	4.6%	6.7%	6.4%	3.1%	1.4%	-
Overall	39.0%	40.0%	40.9%	42.1%	42.1%	43.7%	43.2%	-
	2020	2021	2022	2023	2020	2021	2022	2023
Import Dependency [%]	45.5%	38.3%	38.2%	32.7%	57.5%	55.5%	62.5%	58.3%
of Solid fossil fuels	89.6%	93.1%	193.2%	87.1%	35.8%	37.2%	45.9%	40.8%
of Oli and petroleum products	105.6%	93.7%	101.5%	99.1%	96.8%	91.7%	97.8%	94.5%
Of Natural Gas	100.1%	100.0%	99.8%	100.1%	65.0%	65.0%	97.0%	90.0%
of Natural Gas	100.0%	100.0%	22.6%	0.0%	41.0%	10.0%	20.7%	0.3%
of Crude Oil	#DIV/01	#DIV/01	#DIV/01	#DIV/01	25.7%	25.2%	18 /1%	3.0%
of Hard Coal	97.0%	40.1%	39.9%	0.0%	49.1%	47.4%	21.5%	1.0%
	571070	101170	551576	0.070	131270		21.575	1.070
	2017	2018	2019	2020	2021	2022	2023	
Gas Consumption (in bcm)	1.2	1.4	1.4	1.1	1.2	0.8	0.8	
Gas Consumption year-on-year change [%]	-11.7%	17.5%	-5.4%	-17.7%	6.6%	-29.0%	-5.0%	
Gas Imports - by type (in bcm)	1.2	1.4	1.4	1.1	1.2	0.8	0.8	
Gas imports - pipeline	1.2	1.4	1.4	1.1	1.2	0.8	0.7	
Gas imports - LNG	0.0	0.0	0.0	0.0	0.0	0.0	0.1	
Gas Imports - by main source supplier [%]								
Lithuania	0.0%	0.0%	0.0%	0.0%	0.0%	75.4%	80.0%	
Estonia	0.0%	0.0%	0.0%	0.0%	0.0%	1.0%	20.0%	
Buccia	100.0%	100.0%	100.0%	100.0%	100.0%	22.6%	0.0%	

Source: Eurostat, ENTSO-E, S&P Platts

ANNEX 9: CLIMATE ADAPTATION, PREPAREDNESS AND ENVIRONMENT

Latvia is at a transitional stage in terms of climate adaptation governance and action on climate risk assessment. Further action is essential to boost the level of preparedness and reduce the impact of economic activities on the natural environment. Degraded ecosystems pose significant risks to the prosperity and competitiveness of the country. Latvia has started its transition towards more sustainable agriculture practices, but the climate and environmental impacts of its agri-food system still warrant additional action.

Climate adaptation and preparedness

Climate change poses significant risks to Latvia, mainly due to changes in precipitation patterns and more frequent extreme weather events. Climate change in Latvia affects not just the environment but also people's health, safety and businesses. Key risks include seasonal shifts, wildfires, the spread of pests and disease and new invasive species. These changes can lead to more respiratory and infectious diseases, heat strokes and floods from heavy rain. Other issues are power disruptions, variations in hydropower, less frequent frost without snow, droughts and damage to infrastructure. There is also less water flow in summer, causing further challenges (¹⁷³). In 2023, 11% of Latvia's total area suffered from drought.

In the Baltic region, climate change might also be impacting public health. This is particularly due to rising sea surface temperatures and the rise in eutrophication, which is expected to increase the spread of waterborne diseases. Vibrio infections are examples of this happening, and they have already been linked to the warming of the Baltic Sea (¹⁷⁴).

At national level, Latvia has made some progress in integrating climate adaptation into its institutional set-up and planning. It developed a national plan for adaptation to climate change that will be revised in 2026. In its final updated 2024 national energy and climate plan, Latvia partially analysed climate vulnerabilities and risks, including power fluctuations, infrastructure vulnerabilities and biodiversity degradation (¹⁷⁵).

There is а need to improve the comprehensive risk assessments. Adaptation measures lack details on financing, implementation, scheduling and scalability. A closer alignment to the modelling could be beneficial as would preparations to manage the potential impacts of rising sea levels on coastal ecosystems, fisheries and aquaculture in the Baltic region.

Latvian regions and cities are also developing their own adaptation policies, although there is limited information on review processes and progress. Since 2018, municipalities have created civil protection plans that include climate impact assessments. Latvia also established procedures for climate monitoring and managing flood risks in highrisk areas.

Latvia draws on a range of funding sources for climate change adaptation. Funded by the state budget, the EU and the European Environment Agency, investments are focused on reducing flood and coastal erosion risks, with an emphasis on 'green and blue' solutions. Disaster management is a priority, with funding allocated to rescue services, environmental monitoring and upgrades to infrastructure. The ongoing recovery and resilience plan includes investments in climate adaptation such as flood

⁽¹⁷³⁾ EEA, 2024, Climate ADAPT, Latvia/Overview of Existing Pressures.

^{(&}lt;sup>174</sup>)EEA, 2024, *European Climate Risk Assessment (p.156)*. (¹⁷⁵)Latvia - Final updated NECP 2021-2030, 2024, <u>Link</u>.

risk reduction infrastructure and disaster management centres.

Water resilience

Despite a wealth of water resources and some improvements made to the ecological status of surface water bodies, Latvia would from additional measures benefit to monitor both surface and groundwater bodies and to boost its water resilience. Latvia has 780 surface water bodies and 25 groundwater bodies. In 2022, Latvia's water productivity was EUR 137 per m³ of abstracted water, on a slight increase over a five-year period. The Water Exploitation Index Plus (WEI+) is low, at 0.2 in 2022 (¹⁷⁶). Latvia has a 99% compliance rate with the EU Urban Wastewater Treatment rules. Recent data from the third river basin management plan for the period 2022-2027 show improvements in the ecological status of surface waters, with 32.5% now in good condition. However, their chemical status assessment has worsened since the last report with 100% of surface water bodies now reported as failing to achieve good chemical status, due to changes in methodology. Only 12% of surface waters are monitored to assess their chemical status due to limited monitoring capacities, and grouping is used to determine the chemical status for the remainder. Failure to meet good chemical status is largely due to the presence of ubiquitous toxic substances, often from transboundary sources. Groundwater bodies are still classified as having good quantitative status, but their chemical status assessment has also declined. The main forms of pressure on water bodies are point sources from urban and to a lesser extent industrial waste water, diffuse sources agriculture and hydrofrom

morphological changes and point sources from urban and to a lesser extent industrial wastewater. The current level of financing for water management in Latvia is around EUR 171 million per year (see Graph A9.2). However, the needs are estimated to be substantially higher, leaving a gap of EUR 171 million and undermining the country's water resilience. Additional investments are needed to improve monitoring and support nature-based solutions, flood prevention and river restoration. The ongoing recovery and resilience plan includes investments in flood risk reduction infrastructure.

Biodiversity and ecosystems

The state of nature and ecosystems in Latvia affects the country's climate resilience. Latvia has rich biodiversity - it is home to 61 types of natural habitats and 109 species of EU importance (¹⁷⁷). However, according to the latest available data, less than 10% of the country's protected habitats have a good status, the fourth worse result in the EU and below the EU-27 average of 14.7%. By contrast, 39.5% of species are reported as having a good conservation status, above the EU average of 27%. Having most protected habitats in an unfavourable conservation status impacts Latvia's climate resilience, as the loss of biodiversity impairs ecosystems' ability to provide services that help mitigate the effects of climate change, such as regulating water cycles, maintaining soil health and storing carbon.

Nature degradation presents significant risks to the economy and to competitiveness as Latvia has one of the highest supply chain dependencies on ecosystem services in the EU. The Latvian economy's supply chain is heavily dependent on ecosystem services, with

⁽¹⁷⁶⁾ Values above 20% are generally considered to be a sign of water scarcity, while values equal or greater than 40% indicate situations of severe water scarcity. Seasonal data for Latvia show that there is no water scarcity even during summer months.

^{(&}lt;sup>177</sup>) EEA, 2019, Number of habitats and species per Member State, Link.

32% of its gross value added showing a high degree of dependency (against the EU-27 average of 22%). In particular, the agriculture, forestry and electricity sectors have a high degree of supply chain dependency on ecosystem services. In terms of overall direct dependency on ecosystem services (37%) Latvia is below the EU average of 44%. However, several sectors such as agriculture, forestry, fisheries and construction (see Graph A9.1). are particularly dependent on ecosystem services. 100% of the gross value added of these sectors is directly dependent on ecosystem services. This means that failure to maintain the capacity of ecosystems to deliver services could entail significant costs or even stop production in these sectors. Protecting and restoring key ecosystems would help maintain the long-term competitiveness of these sectors.

Graph A9.1: Direct dependency(1) on ecosystem services(2) of the gross value added generated by economic sector in 2022



(1) Dependency based on the sector's own operations, excluding value chain operations within countries and across international value chains. A high dependency indicates a high potential exposure to nature-related shocks or deteriorating trends, which means that the disruption of an ecosystem

service could cause production failure and severe financial loss.

(2) Ecosystem services are the contributions of ecosystems to the benefits that are used in economic and other human activity, including provisioning services (e.g. biomass provisioning or water supply), regulating and maintenance services (e.g. soil quality regulation or pollination), and cultural services (e.g. recreational activities).

Source: Hirschbuehl et al., 2025, *The EU economy's dependency on nature*, <u>Link</u>.

Targeted action on nature protection and restoration is needed for Latvia to meet its nature restoration targets. In 2022, 18.1% of its land was protected, below the EU-27 average of 26.1%. Latvia would need to restore up to 3 141 km² of habitats listed in Annex I to the Habitats Directive, corresponding to up to 4.9% of its land (¹⁷⁸). Latvia requires EUR 1

^{(&}lt;sup>178</sup>)European Commission (2022), Impact assessment accompanying the proposal for a Regulation on nature restoration.

billion of investment per year to effectively protect and restore its natural capital, mitigate the impacts of climate change, and maintain the country's rich biodiversity (see Graph A9.2). The current level of financing for biodiversity and ecosystem conservation in Latvia is around EUR 119 million per year. It has a substantial investment gap of EUR 894 million, which undermines the country's commitment to global biodiversity agreements and its longterm economic and social development.

Graph A9.2: Investment needs and gaps in EUR million, in 2022 constant prices



Source: European Commission, DG Environment, Environmental investment needs & gaps assessment programme, 2025 update.

Sustainable agriculture and land use

Latvia's carbon removals fall short of its 2030 target for land use, land-use change and forestry (LULUCF). Latvia's LULUCF sector has become a net greenhouse gas (GHG) emitter in recent years. Net carbon removals through land use have fluctuated widely each year since 2017, with emissions from the sector doubling in the most recent GHG inventories. Increased logging and high emissions from organic soils (degraded peatlands) are the main driving force behind the country's LULUCF emissions. To meet its 2030 LULUCF target, additional carbon removals of -0.6 million tonnes of CO₂ equivalent (CO₂eq) are needed (¹⁷⁹). The latest available projections show a gap to target of 5.5 million tonnes of CO2eg for 2030 (¹⁸⁰). Latvia should prioritize protecting its natural capital by implementing sustainable land management practices that enhance carbon sequestration, as this not only mitigates also supports emissions but long-term economic development by preserving the natural resources vital to its economy (¹⁸¹).

Although Latvia's overall greenhouse gas emissions from agriculture are relatively moderate, agriculture is still a source of emissions and continues to have an impact on air, water and soils. In 2022, agriculture generated 2.3 million tonnes of CO₂eq, accounting for around 21.3% of the country's emissions (excluding LULUCF). This total includes 1.1 million tonnes of CO2eq from livestock farming. Wetlands (including peatlands) are an important driver of GHG emissions in Latvia's LULUCF sector comprising about 38% according to the latest available data. Large majority of the specific wetlandrelated emissions are attributable to peat extraction for horticulture. The utilised agricultural area (UAA) in Latvia increased by 5.2% from 1.9 million hectares in 2014 to 2 million hectares in 2023. The country's nitrogen balance is 15.1 kg of nitrogen per hectare of UAA and nitrates in groundwater do not exceed the healthy threshold for human consumption. As the livestock density has fallen to the index level of 0.24 in 2020, three times below the EU average of 0.75, ammonia emissions have also fallen, dropping 6.7%

^{(&}lt;sup>179</sup>)National LULUCF targets of the Member States in line with Regulation (EU) 2023/839.

⁽¹⁸⁰⁾ Climate Action Progress Report 2024, COM/2024/498.

⁽¹⁸¹⁾ A recent JRC study highlights that a 10% increase in natural capital results in a 0.7% rise in the gross value added (GVA) within EU regions. <u>https://publications.jrc.ec.europa.eu/repository/handle/JR</u> <u>C139761</u>

between 2018 and 2022. Between 2017-2022, pesticides were detected at levels exceeding the set thresholds in almost half of the rivers (47%) (¹⁸²).

Support under the common agricultural policy (CAP) in Latvia is designed to help achieve the environmental and climate objectives. The CAP strategic plan contains different measures contributing to climate change mitigation, pollution reduction, biodiversity conservation and sustainable forestry. The plan will allocate significant financial resources from both the rural development and direct payments budget for this purpose. Under seven different ecoschemes, farmers may receive support for agricultural practices that are beneficial for the environment and climate, for ecological focus areas and to carry out agro-ecological practices in organic farms. Under the rural development heading, funding is allocated to different agrienvironmental schemes and other support measures related to the achievement of environmental and climate objectives. Latvia will also prioritise the development of organic farming, supporting the aim to have 18.8% of agricultural land under organic farming by 2027 (in 2022 15.9% of UAA was under organic farming).

Latvia plans to cover over 70% of the utilised agricultural area by commitments to protect and improve soil quality, and over 24% by commitments to protect water quality. For example, support will be paid to reduce the use of pesticides in 682 000 hectares and thus reduce their negative impacts on the environment. About 24% (or 460 000 hectares) of utilised agricultural area is planned to contribute to the aim of protecting and restoring biodiversity, including through high-quality agricultural practices such as buffer strips, environmentally friendly

(182) EEA, 2024, Pesticides in rivers, lakes and groundwater in Europe, <u>Link</u>.

horticulture and management.

grassland

biotope

Table A9 1 [.] Key	indicators trac	kina progress o	on climate ada	ptation, re	esilience and	environment
TUDIC AJ. I. KC	maicators trac		II cilliate aua	plation, it	contence and	environnent

Nimete adaptation and proparadosas			Latvi	2			EII 2	7
annate adaptation and preparedness.	2018	2019	2020	2021	2022	2023	2018	20
Drought impact on ecosystems	7.35	19.15	1.61	4.83	0.99	10.71	6.77	2
[area impacted by drought as % of total]								
Forest-fire burnt area (1)	177	177	177	177	177	177		
[ha, annual average 2006-2023]								
Economic losses from extreme events	120	-	-	-	-	17	24 142	62 98
[EUR million at constant 2022 prices]								
Insurance protection gap ⁽²⁾	-	-	-	-	1.75	1.75		
[composite score between 0 and 4]								
Heat-related mortality ⁽³⁾ [number of deaths per 100 000 inhabitants in 2013- 2022]	33	33	33	33	33			
Sub-national climate adaptation action [% of population covered by the EU Covenant of Mayors for Climate & Energy]	59	60	60	61	60	67	41	
Vater resilience:			Latvi	a			EU-2	27
	2018	2019	2020	2021	2022	2023	2018	20
Water Exploitation Index Plus, WEI+ ⁽⁴⁾ [total water consumption as % of renewable freshwater resources]	02	0.2	0.2	0.2	0.2	-	4.5	
Water consumption	63	61	63	64	63	-		
[million m ³]								
Ecological/quantitative status of water bodies (5)								
[% of water bodies failing to achieve good status]								
Surface water bodies	-	-	-	68%	-	-	-	ę
Groundwater bodies	-	-	-	0%	-	-	-	ç
N - 11			Letu	-			EU 2	17
addiversity and ecosystems:	0040	0040	Ldtvi	a 0004	0000	0000	EU-2	.7
Company at the status of he bits to (6)	2018	2019	2020	2021	2022	2023	2018	2
P/ of habitats having a good conservation status	9.0	-	-	-	-	-	14./	
Common farmland bird index	103.2	01.8	02.2	97.2	87.8	_	72.2	
2000=100	1052	31.0	52.2	51.2	07.0	_	122	
Protected areas	-	-	-	18	18	-	-	
[% of protected land areas]								
• / •								-
ustainable agriculture and land use:			Latvi	а			EU-2	27
	2018	2019	2020	2021	2022	2023	2018	2
Bioeconomy's added value (7) [EUR million]	2 262	2 405	2 655	3 324			634 378	716
Landscape features	-	-	-	-	4	-		
[% of agricultural land covered with landscape features]								
Food waste	-	-	-	-	-	-		
[kg per capita]								
Area under organic farming [% of total UAA]	14.5	14.8	14.8	15.3	15.9		7.99	
Nitrogen balance	26.6	13.3	10.9	15.1	-	-		
[kg of nitrogen per ha of UAA]								
Nitrates in groundwater ⁽⁸⁾	3.3	3.6	3.3	3.4	-	-		
[mgNO ₃ /l]								
Net greenhouse gas removals from LULUCF ⁽⁹⁾ - [Kt QQ ₂ -eq]	- 388 -	1 969	758	2 202	4 944		- 256 077 -	240 9

(1) The data show the average for the timespan 2006-2023 based on EFFIS - European Forest Fire Information System. (2) Scale: 0 (no protection gap) – 4 (very high gap). EIOPA, 2024, Dashboard on insurance protection gap for natural catastrophes.

(3) van Daalen, K. R. et al., 2024, The 2024 Europe report of the Lancet Countdown on health and climate change: unprecedented warming demands unprecedented action, The Lancet Public Health.

(4) This indicator measures total water consumption as a percentage of the renewable freshwater resources available for a given territory and period. Values above 20% are generally considered to be a sign of water scarcity, while values equal or greater than 40% indicate situations of severe water scarcity.

(5) European Commission, 2024, 7th Implementation Report from the Commission to the Council and the European Parliament on the implementation of the Water Framework Directive (2000/60/EC) and the Floods Directive (2007/60/EC) (Third River Basin Management Plans and Second Flood Risk Management Plans).

(6) For this indicator, the EU average includes figures for the UK under the previous configuration, EU-28.

(7) European Commission, 2023, EU Bioeconomy Monitoring System dashboards.

(8) Nitrates can persist in groundwater for a long time and accumulate at a high level through inputs from anthropogenic sources (mainly agriculture). The EU drinking water standard sets a limit of 50 mg NO_3/L to avoid threats to human health.

(9) Net removals are expressed in negative figures, net emissions in positive figures. Reported data are from the 2024 greenhouse gas inventory submission. 2030 value of net greenhouse gas removals as in Regulation (EU) 2023/839 – Annex IIa.

Source: Eurostat, EEA.

FAIRNESS ANNEX 10: LABOUR MARKET

The Latvian labour market is performing well, but shows structural challenges, such as growing labour and skills shortages. Investments in labour market support in Latvia are low with spending on active labour market policies (ALMP) among the lowest in the EU, negatively affecting vulnerable groups, including young people, persons with disabilities and women. Likewise, further support to improving workplace safety and working conditions would be beneficial in helping improve labour market productivity and economic competitiveness. Fair working conditions, decent wages, work-life balance, and having access to affordable and guality childcare and long-term care can all contribute to increased labour market participation and productivity, as established in the EU Competitiveness Compass. Wage growth is catching up with the high inflation levels seen in 2022 and 2023, However, disposable household income in Latvia still has to catch up with the EU average for the country's market to be attractive for highly skilled workers. Migration shows promise in helping mitigate shortages.



Source: Eurostat, LFS

Latvia

LV %

40

35

30

25

20

15

10

5

0

The Latvian labour market continues to perform well, but structural challenges persist. In 2024, the employment rate reached 77.4% (vs EU: 75.8%), surpassing the prepandemic high of 77.3% in 2019 (vs EU: 72.7%), remaining consistently above the EU average At the same time, the unemployment rate increased by 0.4 percentage points(pps) to 6.9% in 2024 (vs EU: 59%). The long-term unemployment rate increased by 0.4pps 2.2% in 2024 and is now above the 1.9% recorded in the EU. Despite these positive labour market developments, there are indications that the market suffers from structural issues, including an outflow of highly qualified workers and regional inequalities due to lower economic activity outside of Riga (e.g. in 2022, 65.6% of Latvia's GDP came from Riga vs only 6.7% from Latgale). The ageing of the population is also leading to a decline in the working-age population. The activity rate remained relatively stable at 76.7% in 2024 (vs EU: 75.4%). The crude rate(¹⁸³) of total population change was

⁽¹⁸³⁾The crude rate of total change is the ratio of the population change during the year (the difference

negative at -5.9 in 2023. This was partly due to a lower birth rate than death rate, which in turn was partly due to a decline in the temporary settlement of Ukrainian citizens. The impact of Russia's war of aggression against Ukraine continues to be felt strongly in Latvia, as it significantly reduced the country's trade with Russia and Belarus (for both exports and imports) (¹⁸⁴). The resulting shift in economic negatively affected activity has specific industries and the workers employed in them (¹⁸⁵). There is a growing need for reskilling to facilitate the reallocation of workers to new jobs and to reduce the growing skills mismatches including in the green and digital sector (¹⁸⁶). Addressing the structural challenges will help Latvia reach its 2030 national target of having at least 80% of adults in employment.

Labour shortages and skills mismatches pose challenges in the context of the digital and green transition. The relatively low and decreasing level of digital competency in Latvia poses a significant risk to increasing productivity. Contrary to the EU trend, the number of individuals with basic or above basic digital skills decreased from 50.8% in 2021 to 45.3% in 2023, well below the EU average of 55.6%. At the same time, Latvia experiences shortages in key sectors relevant to the green transition, including refuse sorters, forestry labourers, and insulation workers (¹⁸⁷). Latvia

between the population sizes on 1 January of two consecutive years) to the average population in that year. The value is expressed per 1 000 people.

- (184) Exports and imports by countries (CN at 2-digit level) – Unit, Flow, Commodity CN at 2-digit level, Countries and Time period. Piwe.
- (¹⁸⁵)E.g. the transit, the agriculture, the manufacturing and the education sectors.
- (186) <u>Autumn 2024 Economic Forecast: A gradual</u> rebound in an adverse environment - European <u>Commission.</u>
- (187) Source: European Labour Authority 2025 EURES Report on labour shortages and surpluses 2024, based on data from EURES National Coordination Offices. Skills and knowledge requirements align with the <u>European Skills,</u> <u>Competences, Qualifications and Occupations</u> (ESCO)

has taken steps to address the growing challenge of skills shortages with the development of the human capital development strategy. However, adoption of the strategy is pending, and systematic green skills development appears to be lagging.

Migration can help address demographic and labour market challenges, but the risk of an outflow of skilled workers remains. While the country's accession to the EU in 2004 has brought many advantages, including free movement of people, Latvia also has experienced a significant brain drain over the years, with the heaviest emigration waves witnessed at the start of the previous decade. This occurred on the back of the global recession, which had a particularly sharp effect on the Latvian labour market. Following the subsequent economic recovery, net migration began to stabilise gradually and in 2022 was net positive for the first time since its accession to the EU, largely explained by the arrival of Ukrainian citizens fleeing from Russia's war of aggression in their homeland. In fact, by 2024, the number of foreign workers in Latvia reached 15 558, which is more than double the amount in 2015 (188). On the other hand, it is also increasingly obvious that third-country nationals are overgualified, often occupying vacancies requiring lower qualifications, regardless of their education status. For example, 38.7% of Ukrainians are hired in lowskilled occupations (¹⁸⁹). The share of people with a higher educational attainment level is rising, yet the emigration of well-educated and highly skilled workers could pose significant challenges for Latvia's ability to respond to changing skills demand. In 2022, 24.71% of emigrants were aged 20-29 years old. Young professionals continue to emigrate due to high

taxonomy on skills for the green transition, with examples analysed using the ESCO green intensity index.

^{(&}lt;sup>188</sup>) <u>Number of Foreign Workers in Latvia Has Doubled</u> Since 2015, Exceeding 15 500 This Year.

^{(189) &}lt;u>Latvia izglītojas 4 tūkstoši, Strada 8,7 tūkstoši</u> <u>Ukrainas valstspiederīgo | Oficiālās statistikas portāls.</u>

costs for housing, limited opportunities and low wages. The share of people with at least upper secondary, post-secondary, non-tertiary and tertiary education was 84.0% in 2023 vs 75.3% in the EU. Likewise the share of tertiary graduates was 34.0% vs 30.9% in the EU, demonstrating the high educational attainment level in the labour force.

The activation of vulnerable groups can help labour shortages and benefit tackle productivity. The disability employment gap in Latvia stood at 21.3% in 2024, almost 3 pps below the EU average but has been increasing by almost 3 pps since 2023, which calls for increased activation of this group, which faces a high risk of social exclusion and poverty (Annex 11). According to 2022 data, 34.3% of young persons with disabilities in Latvia were not in employment, education or training. As for adults with a disability 60% were in employment (¹⁹⁰), vs 77.4% for adults overall. Latvia has set a national target of at least 50% of persons with disability being in employment by 2027, based on national data (41.4% in 2022). Latvia has progressed well in recent years in terms of implementing a social economy (¹⁹¹). For example, the Social Enterprise Law (192) has led to a significant increase in the number of persons with disabilities working in social enterprises, from 53 in 2020 to 152 in 2024. To support activation of this group, it would be beneficial if Latvia also continued to invest in workplace adaptations, and the improvement of accessibility to public and private buildings and to support subsidised employment to activate persons with a disability, which has so far had a high success rate. In support of this, EUR 40 million under the European Social Fund Plus for promoting has been allocated the

integration of disadvantaged unemployed and economically inactive people into the labour market though, among other things, subsidised measures to develop work skills, jobs, promotion of job mobility as well as support services for people with disabilities. EUR 10.2 million from the ESF+ will also support social entrepreneurship. Compared to the EU, Latvia has a high share of people 65 and over, who are active participants in the labour market due to poor social security and pensions. Their activity rate increased from 13.5% in 2022 to 14.8% in 2023 (vs EU: 6.6%). Health outcomes are poor (see Annex 14). Old-age poverty in Latvia is among the highest in the EU.

Female employment is high, yet the difference in earnings between men and women remains substantial. Latvia has a comparatively high share of women in employment and the gender employment gap (¹⁹³) only slightly increased 3.3 pps in 2024, very low compared to EU average (10.0 pps). Despite this, women (15-64 years old) remain underrepresented, with a participation rate of 74.6% compared to 78.9% for men. This can be attributed at least partly to the very high gender pay gap (19.0% vs EU: 12.0% in 2024), which is due to the widespread presence of women in low-paying sectors.

Large wage increases have raised some concerns about competitiveness, but wage levels remain low. Nominal wages in Latvia grew by more than 9% in 2022, 2023 and 2024, which led to real wages growing by 6.5% in 2023 and 7.9% in 2024 (after having decreased by 3.6% in 2022 due to high inflation) (¹⁹⁴). However, average wage levels and the standard of living still remain well below the EU average. At the same time, unit labour costs increased significantly more than in most EU Member States, namely by 11.3% in 2022, 13.9% in 2023

^{(190) &}lt;u>European comparative data on persons with</u> <u>disabilities - Publications Office of the EU.</u>

^{(&}lt;sup>191</sup>)Latvijā sievietes darba tirgū sliktākā stāvoklī nekā vīrieši / <u>Rakst.</u>

^{(&}lt;sup>192</sup>) <u>Social Enterprise Law (</u>Sociālā uzņēmuma likums), 2018.

^{(&}lt;sup>193</sup>)For those aged 20-64 years old; calculated on basis of the employment rate of men/ the employment rate of women.

⁽¹⁹⁴⁾Based on the European Commission Autumn 2024 economic forecast.

and 8.9% in 2024, pointing to competitiveness issues. A recent tax reform aims to boost competitiveness and purchasing power. To raise competitiveness and reduce the tax particularly burden, for low-income households, the government adopted a labour tax reform in 2024 with changes in personal income tax and non-taxable minimums, including for pensioners, coming into force as of 2025. The reform provides for the easing of the tax wedge (the taxation of earnings from labour) on low-income earners and even more so for medium-income earners. This should help increase the levels of net disposable incomes and reduce income inequality, with the Gini coefficient disposable income to drop from 0.3304 to 0.3286 in 2025 (¹⁹⁵).

Poor healthcare indicators and a rapidly ageing population particularly strain the labour market. The total population declined by 0.59% (vs 0.37% growth in the EU), while the natural change in population, excluding migration, declined even faster at -0.72% from 2022 to 2023. At the same time, Latvia has continuously deteriorated since 2015 and is now recording its lowest birth rates since 1920. The median age stood at 43.9 years old (vs EU: 44.5 years old) in 2023 and the share of the population aged 65 and over rose from 18.8% in 2013 (vs EU: 18.3%) to 21.0% in 2023 (vs EU: 21.3%) (¹⁹⁶). Life expectancy remains amongst the lowest in the EU at 75.9 years and the share of the population with unmet needs for medical care is one of the highest in the EU (see Annex 14). The projected gradual increases in the old-age dependency ratio and in skills shortages (¹⁹⁷) are expected to put an additional strain on the labour market, the social security system and economic growth in the coming decades. It is therefore important for Latvia to strengthen labour market and social resilience, including by boosting the

(195)Based on a Euromod simulation in 2024.

coverage and the quality of healthcare and social services.

Latvia is taking steps to improve job quality.

The quality of work depends on several factors, employment notably security, work-life balance, health and safety at work, access to training, career development and pay. Latvia has taken several steps in recent years with a view to create fairer working conditions, in line with the principles of the European Pillar of Social Rights. The government has transposed the Minimum Wage Directive in 2024, introducing a transparent minimum wage setting mechanism. Collective bargaining remains low, hindering quality of jobs. During the early 1990s, trade union density exceeded 50% of the workforce, but it dropped to just 11.6% in 2018 (¹⁹⁸). Similarly, the collective bargaining coverage is also low at 27.1% (¹⁹⁹). Successful industrial level agreements have recently been made in the construction, longterm care and fibreglass sectors, but further industry-level agreements should be encouraged to improve working conditions and wages.

A further strengthening of workplace safety and prevention of preventable mortality and health of the workforce would improve job quality. Latvia has some of the highest numbers of fatal accidents at work, with 2.98 incidents per 100 000 employed in 2022 (vs EU: 1.66 per 100 000 employed). Moreover, in 2021, the number of preventable causes of mortality stood at 439 per 100 000 (standardised rate for people aged under 75) vs 212 per 100 000 in the EU and the number of treatable causes of mortality at 205 per 100 000 (standardised rate for population under 75) vs 93 per 100 000 in the EU. The number of healthy working years is one of the lowest in the EU with the health expectancy standing at 63 years at birth (vs EU: 73.0). This

^{(&}lt;sup>196</sup>) <u>Population structure and ageing - Statistics</u> <u>Explained.</u>

⁽¹⁹⁷⁾ Darba tirgus ziņojums | Ekonomikas ministrija.

⁽¹⁹⁸⁾ OECD Data Explorer • Trade union density.

^{(199) &}lt;u>OECD Data Explorer • Collective bargaining</u> <u>coverage.</u>

highlights the usefulness of further improving disease prevention and workplace safety adaptations in Latvia, given that a healthy workforce, in addition to its moral added value, has a much higher potential to increase productivity, therefore supporting economic growth.

Job satisfaction is relatively high with further measures supporting good working conditions in the making. While general job satisfaction is above the EU average (7.6 vs 7.4), low skilled people (i.e. those who attained an education below upper secondary level) show lower job satisfaction than the rest of the population (²⁰⁰). Going forward, Latvia is expected to adopt a substantial package of amendments to the Labour Law (²⁰¹) in 2025 for the improvement of working conditions, incl. improved protection in cases of a sick child and the introduction of a flexibility for a 4-day working week (maintaining 40 hours).

Further efforts to prepare the workforce for the green and digital transitions are needed.

Between 2016 and 2021, employment in the Latvian environmental goods and services sector declined by 0.2 pps to 2.8% of total employment but remained above the EU average (2.7%). The job vacancy rate in construction, a key sector for the green transition, is below the EU average (2.8% vs 3.8% in 2023). The greenhouse gas emission intensity of Latvia's workforce has only slightly improved, decreasing from 11.7 tonnes per worker in 2015 to 10.8 in 2022 (EU: 12.3 tonnes). The share of workers (aged 25 to 64) with at least basic digital skills is at 53.9%, well below the 65% in the EU. Latvia's initiatives under its recovery and resilience plan focus on improving ICT skills and increasing the country's number of ICT specialists. These include training 3 000 specialists in advanced digital skills by 2027, implementing targeted programmes to promote STEM education, i.e., in science, technology, engineering and mathematics, and increasing regional job mobility. Despite these efforts, the country's envisaged ICT specialist share of 9.8% by 2030 remains ambitious.

^{(200) &}lt;u>Statistics | Eurostat.</u>

^{(&}lt;sup>201</sup>) <u>Plānoti apjomīgi grozījumi Darba likumā. Ko tie</u> paredz? - LV portāls

ANNEX 11: SOCIAL POLICIES

While social outcomes show some improvement, Latvia still faces persistently high levels of inequality and still significant risks of poverty and social exclusion, particularly impacting older people. High inflation in recent years has fallen, but the effects have yet to trickle down since households continue to feel the pressure in meeting their essential needs. The population is ageing and there is potential to activate the groups that are not yet in the labour market to meet its needs including in healthcare and social care. The social protection system capacity remains limited and access to quality services remains uneven across municipalities, posing risks for sustainable and inclusive economic growth. Moreover, Latvia's middle class, which could play a vital role in consumption and thus contribute to economic prosperity, is one of the smallest in the EU. There is also low upward social mobility for low-income groups. Addressing these challenges will contribute to inclusive growth and competitiveness.

Poverty and social exclusion remain high, despite long-term convergence and recovery from the COVID-19 pandemic. The rate of people at risk of poverty or social exclusion (AROPE) stood at 24.3% in 2024, standing much above the EU average of 21.0%. This is now for the first time lower than the 2020 value (25.1% in Latvia vs EU: 21.5%). The severe material and social deprivation rate has fallen from a spike of 7.8% in 2022 to 6.2% in 2023, and in 2024 was back to the 5.3% low of 2021. This correlates to the negative socioeconomic impact of the COVID-19 pandemic, which was most negatively felt in 2022. There is a longer-term downward trend, with poverty or social exclusion rates in Latvia falling from 30.0% in 2015 to 24.3% in 2024. This is largely attributed to the above EU average economic growth and the continued long-term convergence process (with real GDP per capita as a percentage of the EU average growing from 40.6% in 2015 to 45.4% in 2023) as well as some improvements in the income redistribution system this period. over

Nevertheless, in 2022, the share of general government expenditure on social protection was only 13.2% of GDP (EU: 19.4%).

The impact of social transfers (other than poverty reduction pensions) on has increased in the longer term from 17.6% in 2015 (EU: 32.0%) to 21.5% in 2024 (EU: 34.4%) but remains one of the lowest in the **EU.** The adequacy of minimum income was very low in Latvia, as the income of a recipient was 45% of the poverty threshold (EU: 55.6%) and 37.8% of the income of a low wage earner (EU 46.1%). Sustained efforts will be needed to reach the national poverty reduction target of 95 000 fewer people at risk of poverty or social exclusion by 2030, with Latvia so far having achieved about one third of the envisaged reduction. While the minimum income reform implemented as part of the recovery and resilience plan (RRP) has established a transparent methodology for minimum income and pensions support, Latvia could consider exploring further ways to enhance public spending on social protection and income support mechanisms with socio-economic developments (e.g. inflation or wage increases).

Persistent high-income inequality continues to exacerbate poverty risks. The S80/S20 ratio at 6.28 remained among the highest in the EU in 2024 (EU: 4.66). Thus, the income of the richest 20% of the population is more than six times that of those in the lower quintile. The reducing impact of taxes and transfers on income inequality is one of the lowest in the EU (31% vs 49% in the EU) (²⁰²). In-work poverty however has fallen by one percentage point to 8.2% in 2024 and is now in line with the EU average. A key factor influencing income inequalities is the high share of low wage earners (in-market income inequality), while the coverage of collective bargaining is low (²⁰³).

^{(&}lt;sup>202</sup>) European Commission, Economic inequalities in the EU, July 2024.

^{(&}lt;sup>203</sup>) European Commission, Economic inequalities in the EU, July 2024.

The 2025 labour tax reform is primarily expected to benefit middle-income households but will also positively contribute somewhat to reducing inequality and poverty(²⁰⁴). The reform should be carefully monitored in the coming years, in line with income developments.

The extent of work intensity and type of employment impact the risk of poverty. The at-risk-of-poverty rate for households with a very low work intensity is very high, standing at 77.4% (EU: 62.9%), compared to 27.9% (EU: 25.2%) for those with middle-work intensity and 8.0% for those with high-work intensity (EU: 9.4%). Self-employed, temporary workers and part-time workers as well as all those in non-standard forms of employment are at a significantly greater risk of poverty, given the more limited social protection coverage. Inwork poverty is significantly higher for employees with a temporary contract at 22.5% in 2022 and 10.7% in 2023, compared to those with a permanent contract, standing at 7.2% and 7.1% respectively. On the upside, the Latvian labour market is characterised by a large share of full-time and permanent employment contracts (see Annex 10).

While inflation has stabilised, food and high, energy affecting prices remain disproportionately lower income households. General inflation has fallen from a peak of 17.2% in 2022 (EU: 9.2%) to 1.2% in 2024 (EU: 2.5%). Over а longer-term perspective, food prices were 66.5% higher (EU: 44.8%) and the energy prices 49.9% higher (EU: 49.2%) at the end of 2024 than in 2015, affecting disproportionately lower income households. In response, the Ministry of Economics is exploring potential mechanisms to cap food prices in grocery stores in 2024. However, no measures have so far been adopted. The continued pressure of high energy costs on low-income households is partly reflected by an increase in arrears on

utility bills, rising from 5.9% in 2022 to 7.0% in 2023 (EU: 6.9%). Latvia could benefit from exploring options to reduce the energy poverty risk, including through the Social Climate Fund plan.

Rural areas and certain population groups are particularly vulnerable. 38.5% of persons with disabilities were at risk of poverty and social exclusion in 2023, 19.4 pps higher than those without disabilities. Moreover, over 50% of persons with severe disabilities were at risk of poverty and social exclusion in Latvia in the same year, which was one of the highest rates in the EU. In 2024, the persons at-risk-ofpoverty and social exclusion (AROPE) rate in rural areas was 29.4% (EU: 21.3%) and 19.3% (EU: 21.4%) in the cities, highlighting a significant rural-urban divide in Latvia. This is due to lower economic activity, opportunities and average income in the rural areas, which also result in higher unemployment outside of the capital region of Riga (205). The risk of poverty risk has decreased significantly for lowskilled workers (i.e. with qualifications of ISCED levels 0-2) from 37.5% in 2022 (EU: 29.0%) to 29.2% in 2023 (vs EU: 29.4%). This development correlates with the increase in the minimum wage from EUR 500 to EUR 620 in 2023. The risk of poverty for medium-skilled workers (i.e. with qualifications of ISCED levels 3-4), however, has increased from 21.3% in 2022 to 23.2% in 2023 and remains much above the EU average of 14.4%. The two groups represent 16.0% (EU: 24.7%) and 50.0% (EU: 44.4%) of the total population respectively. The figures highlight the scale of the need for both upskilling and better working conditions. Women also face a higher risk of poverty or social exclusion than men at 26.3% vs 22.0% in 2024 respectively. This is probably due to women working in sectors with lower wages and their lower participation in the labour market (74.4% for women vs 79.0% for men).

^{(&}lt;sup>204</sup>) Based on Euromod simulation 2024.

^{(205) &}lt;u>Bezdarba statistika | Nodarbinātības valsts aģentūra</u>

The number of children at risk of poverty or social exclusion is rising. The at-risk-ofpoverty and social exclusion rate for children remains well below the EU average at 17.9% vs 24.2% in 2024, which is below the 2019 value of 18.7% (EU: 22.8%). Children at risk of poverty and social exclusion are facing higher levels of unmet medical needs and are more exposed to living in overcrowded housing (²⁰⁶). In 2023, Latvia adopted a national action plan to implement the European Child Guarantee (ECG), highlighting its intentions to improve the monitoring and support of vulnerable children. Further work is needed to reduce the gaps in support for the most vulnerable groups, as the current support mechanisms and the national ECG action plan lack a targeted approach (²⁰⁷). Latvia has so far not set a national target for 2030 to reduce the number of children at risk of poverty.

The risk of poverty is especially high for older people, primarily impacted by low pension adequacy. In 2024, 42.9% of persons over the age of sixty-five were at risk of poverty (EU: 19.4%). Pension adequacy is relatively low. The aggregate replacement ratio has decreased from 0.50 in 2023 to 0.44 in 2024 with the gap to the EU average now markedly widening. By contrast to the EU, where the aggregate replacement ratio for pensions is by 0.04 pps higher for men than women, it is 0.04 pps lower for men compared to women in Latvia. Nevertheless, men have higher contributions based on their wages throughout their careers and also receive higher old-age pensions, with the average standing at EUR 547.90 vs EUR 495.90 for women in 2023 (national average EUR 513.70). Pensions as share of GDP is one of the lowest in the EU, standing at 7.9% vs EU average 12.9% in 2021. Latvia has taken steps in recent years to improve pension adequacy through indexation, raised nontaxable minimums and the reintroduction of pension supplements for those who retire(d) between 2012 and 2028 for the years worked until 1996. However, it would be beneficial to continue working on raising pension adequacy in order to alleviate the very high old-age poverty rate (e.g. through the acceleration of a base pension reform or a strengthened indexation mechanism).

Social services remain under-developed, and their quality varies across municipalities. Social services are provided mostly by municipalities with the richer ones in the position to offer higher quality and a broader range of services than the poorer ones. The reform 'minimum basket of social services', of which the first phase entered into force in January 2025, aims to implement a minimum set of social services that each of the municipalities must provide in order to allow for a more equitable access to social services across the country. The ESF+ and ERDF will contribute to the implementation of the minimum services basket with a combined of EUR 97.5 million for allocation the development of community-based services. The success of the reform will depend largely on the provision of the necessary financial support to all municipalities. Implementation will require a thorough consideration of the needs and the regional disparities taking into account the current quality of offers at the individual municipality.

Increasing defence spending due to the geopolitical situation risks weakening the much-needed funding of the social protection system further. For years, Latvia has had low levels of general government expenditure on social protection. This situation has been exacerbated by Russia's war of against Ukraine, aggression as defence spending has since grown significantly from 2.4% of GDP in 2022 to 3.1% in 2023. The required funds have been provided through cuts in government expenditure in both healthcare (with a budget down from 5.6% in 2023) and social protection (down from 14.0%

^{(&}lt;sup>206</sup>) Overcrowding rate by age, sex and poverty status total population - <u>Statistics | Eurostat.</u>

^{(&}lt;sup>207</sup>)Given that the support schemes for children in Latvia are universal and the income assessment and the provision of social services is with the municipalities.

in 2022 to 13.6% in 2023). In its 2025 budget, Latvia has earmarked indicatively 3.45% of GDP for defence, which might further increase the risk of cuts to the social protection budget in the years to come. The social protection budget is nevertheless crucial for improving social cohesion and resilience, and particularly needed in the EU external border region of Latgale as it has been disproportionally affected by the war.

Graph A11.1:Share of population aged 65 or over, on 1st January and by sex, 2023, 2030, 2040, and 2050.



Estimated/provisional values for the EU in 2023. Eurostat baseline projections of population for 2024 onwards. *Source:* (1) Eurostat (demo_pjangroup, proj_23np)

Demographic ageing and poor healthcare indicators indicate a growing demand for quality long-term care services. The population of Latvia is ageing, with the share of people aged sixty-five and above expected to increase by more than 45% between 2023 and 2050. Latvia also shows some of the weakest healthcare outcomes in the EU (see Annex 14). However, the number of people aged sixty-five and above, who actually receive long-term care (LTC) services, stands at only 9% of the total population in this age cohort, while the demand for residential LTC and home care is growing. In the capital city of Riga, the waiting lists for residential care reached more than 800 people by mid-2024, while the number of people receiving home care grew substantially from 5 800 people in the first half of 2023 to 6 300 people in first half of 2024. To address the rising challenge of LTC needs with appropriate policies, it is important for Latvia to develop its data collection and monitoring

system for LTC. The data collection should provide information about existing care services and number of places available, the number of people on waiting lists and average waiting times and also about regional disparities in offer, places and waiting times. This would be an important policy planning tool with a view to the strong expected increase in such cases, due to the ageing population.

Access to affordable and quality LTC limited, healthcare services are and outcomes are poor. Public spending on LTC stood at 0.5% of GDP, remaining much lower than the EU average of 1.7% in EU in 2022. Public spending on home care is particularly low at 17% of total LTC public spending, compared to 28.8% in EU in 2022. The share of the older population (sixty-five or over) in need of LTC, who used formal home care services in the past twelve months was far below the EU average (14.6% vs 28.6% in the EU in 2019). Considering this situation, the implementation of a minimum social services basket and the development of a sustainable LTC financing model in the coming years remains vital. The situation is made worse by formal and informal LTC worker shortages, which require specific policy action to attract and retain social care workers.

House prices have sharply increased over the last decade. House prices have almost doubled over the last decade in nominal terms. The growth in house prices has moderated in more recent years (+3.7% in 2023, following two years of sharp increases with +10.9% in 2021 and +13.8% in 2022). House prices are estimated to be overvalued by around 15% and have increased slightly further in 2024 (+5.4% in Q3-2024 year-on-year). House sales and building permits have fallen since 2021, showing adjustment to higher interest rates.

Overall, housing affordability has remained stable over the last decade and new housing supply remains low. Since 2015, house prices have grown slightly faster than household income and the standardised house price-toincome ratio steadily rose until 2022 (13% increase between 2015 and 2022) but corrected in 2023, with the overall increase standing at 6% from 2015 to 2023. At the same time, this ratio remains below its long-term average. The ratio of dwellings per capita has increased by 6% since 2015, reflecting a stable number of dwellings and a decrease in population (-5% since 2015). Despite a mild increase over the past years, the ratio of house completions per capita remains among the lowest in the EU. Residential building permits have been stable over the past years. Latvia's process for issuing building permits is lengthy and includes excessive red tape around building regulations. Taking into account the cost of mortgages, the borrowing capacity of households worsened over the past decade since an average household needs a significantly higher share of its annual income for mortgage repayments. While the rental market is very small, the ratio of new rents to incomes has fallen over the last decade.

There is a shortage in quality housing. While the housing cost overburden was lower than the EU average (6.7% vs EU 8.2%) and falling in line with the EU trend, the existing housing stock is of poor quality and the offer for affordable new housing is very limited (208), which has an impact on labour mobility, especially in the regions. While Latvia has very high levels of property ownership (70% outright and 10% with mortgage) investments in the existing properties is limited, due to high poverty and low wealth of the middle class. The overcrowding rate is the second highest in the EU at 39.3% in 2024, the share of the population having neither a bath nor a shower in their dwelling is the second highest in the EU (9% in 2020). In response to these challenges, Latvia has adopted an Affordability Housing Strategy for 2023-2027 and also launched an Affordable Housing Fund for the development of low-cost municipal rental apartments under

the RRP. The European Regional Development Fund (ERDF) will also invest EUR 70 million in the development of social housing. Yet, more efforts are required for the construction of and the renovation towards high quality housing, to meet the EU objectives of climate neutrality in a socially just manner, protecting specifically the lower income and more vulnerable households.

Social housing remains inadequate and a comprehensive national strategy to address homelessness is lacking. In 2023, more than 5 000 people were on a waiting list for social housing, with the average waiting time for municipal housing in Riga standing at six and a half years. The existing stock of social housing is small (2% from total number of dwellings vs EU 7.5%) and of poor quality (in 2018, only 1 046 free municipal apartments out of 3 286 were deemed adequate for living). At the same time, data collection on homelessness is limited (with data only available in municipal shelters). According to the latest national estimates for homelessness (2022), 5 977 people are homeless, representing 0.32% of the total population. Of these, 19% are women and 81% are men(²⁰⁹). There is also no targeted strategy to address homelessness at the national level, despite both the Ministry of Welfare and the Ministry of Economics working towards potential solutions. At municipal level, Latvia has successfully piloted the Housing First approach in Riga, Valmiera and Liepaja with the support of the European Social Fund. Latvia could benefit from further upscaling its approach in other municipalities.

^{(&}lt;sup>208</sup>) see Housing Guidelines 2023-2027.

^{(&}lt;sup>209</sup>) OECD Country Notes on Homelessness data.

ANNEX 12: EDUCATION AND SKILLS

Skills shortages, unequal access to quality education and low levels of adult learning Latvia's competitiveness. hamper The education system performs comparatively well overall but faces challenges in tackling territorial gaps in basic skills proficiency and ensuring quality education throughout the country. Rapidly changing labour market needs, including those stemming from the green and digital transitions and other technological changes, together with Latvia's shrinking workforce, put pressure on the education and training systems to better equip young people and adults with a broad range of relevant skills. Higher education and vocational education and training (VET) do not yet adequately respond to labour market needs, leading to skills mismatches. A low share of science, technology, engineering and maths (STEM) graduates and low levels of digital skills further exacerbate skills shortages. Targeted policies are in place and key reforms are under way at all levels of education but will require efforts and monitoring sustained and evaluation to ensure their effectiveness.

Ensuring a sufficient supply of quality early childhood education and care (ECEC) remains a priority. In 2024, 96.1% of children from 3 to school age were enrolled in ECEC, and thus already surpassed the EU target of 96% by 2030. However, the share of children under three enrolled in formal ECEC which has the risen steadily over past decade, experienced a sharp decline in 2024, dropping by 10pps to now 24.9%. This is far below both the EU average of 39.2% and the Barcelona target of 41% by 2030. Latvia's Education Law stipulates that all children are legally entitled to a place in ECEC from the age of 18 months. However, there is a shortage of public places in ECEC in some areas, especially in municipalities close to Riga. The government's guidelines on the development of education for 2021-2027 include the goal to improve access to ECEC for 1-4-year-olds. The move to competence-based teaching and learning has been under way in preschools since 2019.

Latvia's education system produces good basic skills, but further results in improvement would sustain future skills **development.** The proportion of 15-year-olds underachieving in reading, mathematics and science, as measured by the OECD Programme for International Student Assessment (PISA), has remained consistently below the EU average since 2013, and Latvia is one of the top-performing EU countries in science proficiency. Even so, more than 20% of 15year-olds have insufficient basic skills in mathematics and reading (22.2% and 22.8% in 2022 vs the EU average of 29.5% and 26.2% respectively), which could harm future skills development. The proportion of topperforming students is below the EU average in all three domains and has been for the past decade.

Students' socio-economic status has a limited influence on learning achievement, but disparities between areas and types of school are significant. Latvia's proportion of early leavers from education and training (ELET) among 18-24-year-olds is among the lowest in the EU (7.9% in 2024) and is well below both the EU average of 9.3% and the EU target of less than 9% by 2030. According to PISA 2022, Latvia has one the smallest socio-economic gaps in underachievement in mathematics (28.0 percentage points (pps) against an EU average of 37.1 pps). The rate of underachievement among students from the bottom guarter of the distribution also remains well below the EU average (36.9% vs 48.0%). However, basic skills proficiency levels vary significantly by geographical area and type of school. The PISA 2022 results confirm that access to quality education still depends on place of residence: larger urban schools, particularly in Riga, continued to perform much better than smaller rural schools. The differences are even greater between different types of school, with students from state 'gymnasiums' scoring significantly higher than students from high schools and basic schools, with differences of 52 and 72 score points respectively. The government is pursuing a

policy of streamlining the school network, which is expected to help overcome territorial disparities.

Renewing the teaching workforce is a challenge with long-term consequences for the quality of education. Despite government remains efforts, teaching а relatively unattractive option for young graduates, and teacher shortages are becoming apparent. Retraining programmes for future teachers have proven successful and continue to attract new participants, both with and without teaching experience. However, with 37.5% of teachers older than 55 (EU average 24.8%) (²¹⁰), the number of new participants is unlikely to be sufficient to replenish the teaching workforce.

Latvia is reforming the VET system and has become more flexible, but the employability of VET graduates remains low. VET reforms are ongoing and aim to move towards a more flexible and modular approach. In 2023, Latvia passed regulatory amendments that improved VET gualification recognition, including for the partial completion of а professional qualification. The reform has also introduced the issuing of qualifications in digital format. In 2023, all VET institutions were assigned a role to lead the coordination of the design and revision of VET curricula in at least one sector. In addition, in 2024, Latvia introduced a VET graduate tracking tool(²¹¹). The number of upper secondary vocational students increased slightly from 24 120 in 2021 to 24 885 in 2022, but the share of vocational students at upper secondary level remained well below the EU average (at 41.1% vs 49.0% in the EU). While conditions for VET uptake are improving, the employment rate of recent VET graduates stood at 74.8% in 2023, well below the 81% EU average, which poses a risk for attracting future VET students. The level of post-secondary nontertiary vocational education graduates decreased from 1 670 in 2021 to 1 370 in 2022,

in line with the fall in the number of tertiary education graduates. The share of employees with upper secondary or non-tertiary vocational education stood at just 27.4% in 2023, falling from 29.1% in 2022 and remaining far below the EU average of 35.5%.

Vocational education programmes in Latvia are mainly school-based and Latvia could benefit from a further implementation of the work-based learning approach. Since 2015, Latvia has introduced apprenticeship-type schemes labelled as work-based learning (²¹²), which provides for a flexible curriculum. However, the introduction of a more businessled learning process could benefit employability and labour market outcomes. To achieve this, it would be essential to strengthen cooperation between educational institutions and employers and to strengthen social partners' capacity for a more effective collective bargaining and dual learning uptake. Yet, collective bargaining coverage stands at only 27.1% of all employees(²¹³), and its influence on the dual learning development and uptake is thus reduced.

The proportion of young adults with a tertiary educational qualification is high, but a wide gender gap persists. In 2024, 45% of 25-34-year-olds had tertiary Latvian а educational qualification, above the EU average of 44.2% and in line with the EU-level target of 45% by 2030(²¹⁴). However, while the tertiary educational attainment (TEA) rate of young women (56.8%) is significantly above the EU average of 49.9%, the rate for men is well below (33.9% vs 38.7%). The resulting gender gap is one of the widest in the EU.

⁽²¹⁰⁾ Eurostat.

^{(&}lt;sup>211</sup>) Education and Training Monitor 2024

^{(&}lt;sup>212</sup>) <u>VET in Europe database | Vocational education and training in Europe | Latvia | CEDEFOP</u>

^{(&}lt;sup>213</sup>) <u>OECD Database on collective bargaining systems was</u> published; <u>OECD temporary archive</u>

^{(&}lt;sup>214</sup>) Eurostat: edat_lfse_o3.





(1) Unemployment rates, ages 20-64 (% of labour force) **Source:** Eurostat, LFS [lfsa_urgaed]

There is scope to improve green competences and skills in school, VET and higher education. Less than a third of Latvian schools offered all or nearly all their eighth graders opportunities to take part in activities related to environmental sustainability (EU-17: 48%) (²¹⁵). Latvian students have one of the lowest levels of knowledge about sustainable among development the EU countries surveyed, even though most teachers (61%) have received training on environmental sustainability.

The number of higher education graduates in STEM remains low despite policy efforts. The government has been promoting STEM subjects by gradually increasing the proportion of publicly financed study places in STEM fields and reducing places in social sciences to steer demand to fields linked to high added-value economic sectors. The Latvian recovery and resilience plan (RRP) sets out various reforms of the higher education system that aim to align university courses with industrial needs and to

(²¹⁵) 2022 International Civic and Citizenship Education Study (ICCS). The average in the 17 Member States surveyed was 48%.

increase the attractiveness of research careers. However, the number of STEM graduates is still low, especially among women: among 2022 graduates, 19.7% were STEM graduates, one of the lowest shares in the EU (average 26.6%). Of these, only about a third (33.1%) were women (or 6.5% of all graduates, compared to an EU average of 9.4%). At 14.7 per thousand, the proportion of STEM graduates among the population aged 20-29 has not changed significantly over the past decade and remains lower than the EU average of 23 per thousand. However, the share of ICT graduates is increasing steadily and remains above the EU average (5.4% vs 4.5% in 2022) (²¹⁶). Only 43.9% of all medium-level VET pupils were enrolled in STEM fields in 2022 (36.2% EU wide).

Latvia is taking steps to boost its innovation potential by increasing the number of PhD graduates, with support from the Recovery and Resilience Facility (RRF). A new doctoral model was launched in the 2024/2025 academic year. The new model ensures adequate pay for doctoral students during their studies and provides for a unified PhD process. Implementation will be gradual, with completion scheduled for early 2027. The lack of researchers and PhD graduates is widely perceived as a barrier to strengthening Latvia's research and innovation system and as a threat to its competitiveness. In 2022, there were 0.3 PhD graduates per thousand inhabitants aged 25-34 (EU average: 1.3), down from 0.5 in 2015. In addition, the government is pursuing its efforts to make higher education funding more efficient and performance based. A new regulatory framework has been developed for allocating base funding for scientific activities to scientific institutions. The framework sets out a link between the results of the international evaluations of these scientific institutions' activities and the scientific activity base funding they receive.

(²¹⁶) DESI indicators.

The skills level plays a key role in the quality of jobs, poverty rates and economic competitiveness. Latvia faces some of the highest levels of poverty and social exclusion in the EU (see Annex 11): low-skilled workers (i.e. with qualifications of ISCED levels 0-2) are much more at risk of poverty (29.2% in 2023 vs 29.4% in the EU) than those with tertiary education (7.5% vs7.2% in the EU). This correlates with the fact that Latvia has very high-income inequality (see Annex 11), with a wage distribution system that puts the lowerskilled at a significantly higher risk.

The Latvian labour market experiences considerable skills shortages (see Annex 10), which hinders economic growth. Real GDP per capita has been catching up over the years, reaching EUR 13 300 in 2023, but it remains well below the EU average of EUR 29 800. This highlights the need for the continued development of the workforce and the adult learning system, with a strong focus on upskilling the lowest skilled workers, which also helps reduce poverty.

Skills shortages are growing, which poses a risk to labour market adaptability, in light of the green and digital transitions. The Latvian labour market is facing growing labour and skills shortages, with the general job vacancy rate standing at 2.7% in 2023, down 0.2 pps from 2022 but up from 2.2% in 2020. Broken down by sector, the job vacancy rates show that Latvia faces significant shortages in construction (2.8%), manufacturing (2.5%), information and communication (2.5%) and (2.6%) (²¹⁷). healthcare and social work According to long-term forecasts (²¹⁸) these shortages will only intensify, affecting, in particular STEM occupations, construction, social care and healthcare (see Annexes 11 and 13). Growing shortages can harm the Latvian

(²¹⁷)Statistics | Eurostat

(²¹⁸) Darba tirgus ziņojums | Ekonomikas ministrija

labour markets' adaptability to the green and digital transitions.

The number of individuals with basic or above at least basic digital skills fell from 50.8% in 2021 to 45.3% in 2023, which is significantly below the EU average of 55.6%. The rate is also the lowest in the Baltics, with 62.6% in Estonia and 52.9% in Lithuania having basic or above basic digital skills in 2023. Under the RRF, EUR 95 million are dedicated for digital upskilling. In 2025, Latvia will launch training programmes for climate neutrality for some 5 500 workers, affected by the peat sector transition, with support from the Just Transition Fund (JTF). At the same time, Russia's war of aggression against Ukraine has harmed trade and key sectors, such as transport and manufacturing. This will require continued investments in upskilling and reskilling the workforce.

Latvia would benefit from an expansion of the current adult learning and training offer, especially for groups underrepresented in training. The percentage of adults who reported having participated in education or training in the last 12 months (²¹⁹)rose from 47.5% in 2016 to 52.2% in 2022. However, this rise was due to an increase in guided-on-thejob training without which the percentage of adults participating in education or training in the last 12 months would have fallen from 39.0% in 2016 to 34.1% in 2022, which is considerably short of Latvia's 2030 target of at least 60%. Certain groups (i.e. men, those aged 45 and older, low-skilled people, unemployed people, rural inhabitants) show significantly lower participation rates than the average. Only 26.5% of men, compared to 41.3% of women, took part in education or training in 2022, while people in cities' participation rate was 2.9 pps higher (at 40.4%) than those living in rural areas. Likewise, only 13.6% of low-skilled (ISCED levels 0-2) compared to 54.7% of high-

^{(&}lt;sup>219</sup>)Eurostat: <u>Adult Education Survey</u>- participation in education and training excluding guided on-the-job training

skilled (ISCED levels 5-8) adults took part in education during that year compared to 54.7% of high-skilled (ISCED levels 5-8). This is reflected in the findings of the State Audit Control report of 2022 (²²⁰), which highlighted that adult education in Latvia fails to reach those with lower skills, who are those most in need of it.

Efforts to establish a sustainable adult learning and training framework are underway, with the support of the EU funds. On the other hand, Latvia has made a significant reform commitment in the context of the RRP to establish a sustainable and socially responsible support framework for adult learning. Measures include supporting employers' needs-based training, piloting individual learning accounts (ILAs), launched in 2024, and piloting sectoral skills funds for a more sustainable financing model. In addition, Latvia put in place a common framework for assessing basic digital skills in formal, nonformal and informal education in 2024 (221). With the support of the European Social Fund Plus (ESF+), Latvia will continue to support adult education based on the individual needs of adults for 28 000 employed people (with funding of EUR 29.4 million). These people will be provided with support for acquiring and improving the skills or qualifications necessary for the labour market. This includes involving 14 000 employed residents with a low level of education in training. Latvia is also expected to develop a systemic approach to monitoring the quality of adult education.

Graph A12.2:**Participation in education and** training by educational attainment level, 2022



(1) % of people aged 25-64; Formal and non-formal education and training (excluding guided-on-the-job training)

Source: Eurostat - adult education survey (AES 2022)

^{(&}lt;sup>220</sup>)<u>Vai pieaugušo izglītība sasniedz tai izvirzītos mērķus un</u> atbilst darba tirgus vajadzībām? | Valsts Kontrole

^{(&}lt;sup>221</sup>) <u>A common framework for the assessment of basic digital</u> skills, the identification and planning of training needs and the assessment based on DigComp | Izglītības un zinātnes ministrija

Table A13.1: Social Scoreboard for Latvia

		Social Scoreb	oard for l	atvia				
		Adult participation in learni the job training, %	ng (during the of the popula	last 12 months, excl. ۽ tion aged 25-64, 2022)	guided on 34,1			
Equal opportunities and access to the labour market	Early leaver (% of the provided	7,9						
	Share of individuals who h (% of the p	tal skills 45,3						
	Young people not i (% of the p	g 10,7						
		Ger (percentage poi	nder employm ints, populatio	ent gap n aged 20-64, 2024)	3,3			
		Ir	ncome quintile (S80/S20, 20	ratio 24)	6,28			
		(% of the p	Employment rate (% of the population aged 20-64, 2024)					
Dynamic labour markets	Unemployment rate (% of the active population aged 15-74, 2024)							
and fair working cond	ditions	Lon (% of the activ	2,2					
		Gross disposable hou: (in	sehold income dex, 2008=100	(GDHI) per capita gro , 2023)	wth 126,1			
		At risk of povert (% of th	y or social exc ne total popula	lusion (AROPE) rate ation, 2024)	24,3			
		At risk of poverty or s (% of the	ocial exclusion population ag	(AROPE) rate for child ed 0-17, 2024)	lren 17,9			
		Impact of social transfers (% re	(other than pe duction of AR	ensions) on poverty re OP, 2024)	duction 21,5			
Social protection	and	Disability employment gap (percentage points, population aged 20-64, 2024)						
		Housing cost overburden (% of the total population, 2024)						
		Children aged less than 3 years in formal childcare (% of the under 3-years-old population, 2024)						
		Self-reported unmet need for medical care (% of the population aged 16+, 2024)						
Critical situation To w	vatch	Weak but improving Good but to monitor	On average	Better than average	Best performers			

1 NO POVERTY

Ň:††:Ť

3 GOOD HEALTH AND WELL-BEIN

4 QUALITY EDUCATION

5 GENDER EQUALITY

8 DECENT WORK AND ECONOMIC GROWT

10 REDUCED INEQUALIT

(1) Update of 5 May 2025. Members States are categorised based on the Social Scoreboard according to a methodology agreed with the EMCO and SPC Committees. Please consult the Annex of the Joint Employment Report 2025 for details on the methodology (https://employment-social-affairs.ec.europa.eu/joint-employment-report-2025-0). *Source:* Eurostat

ANNEX 14: HEALTH AND HEALTH SYSTEMS



Latvia's health system faces significant challenges. These need to be addressed if the country is to improve the health of its social population and fairness, while boosting the competitiveness of its economy. Key challenges include: (i) low life expectancy, linked to high preventable and treatable mortality; (ii) limited access to healthcare; (iii) suboptimal funding and costeffectiveness of the health system; (iv) an insufficient focus on disease prevention; and (v) shortages of healthcare workers.

Life expectancy at birth in Latvia rebounded close its pre-COVID-19 level but was still among the lowest in the EU in 2023. Moreover, there are striking gender gaps in health outcomes. Women can expect to live around 10 years longer than men, one of the widest gender gaps in life expectancy in the EU. However, they can only expect to live around 2.4 years longer than men in good health. The rate of treatable mortality is among the highest in the EU, suggesting shortcomings in the effectiveness of the health system. Diseases of the circulatory system ('cardiovascular diseases') and cancer remain the leading causes of death, with mortality rates higher than the EU average. Latvia participates in several joint actions funded by EU4Health aimed at reducing the burden of cardiovascular diseases, cancer, diabetes and respiratory diseases.



The weak health outcomes negatively impact Latvia's workforce, productivity and competitiveness. In Latvia, mortality at working age as a proportion of total mortality is among the highest in the EU, exacerbating the effects of population ageing on a shrinking labour force. The rate of potential productive life years lost due to non-communicable diseases, such as cancer and cardiovascular diseases, is high (2 512 per 100 000 population) compared to the EU average of 1 017 (²²²). Between 2022 and 2040, the working age population in Latvia is forecast to shrink by 1.2% every year as a result of lower birth rates (EU-level projection: 0.3%).



Age-standardised death rate (mortality that could be avoided through optimal quality healthcare) *Source:* Eurostat (hlth_cd_apr)

Health expenditure in Latvia remains low, as does the share of health spending covered by public funds. In 2022, health spending per inhabitant was among the lowest in the EU and less than two thirds of it was funded by the public purse. The government's medium-term forecast (data from January 2025) suggests that public spending on healthcare as share of GDP will drop each year between 2025 and 2028, falling from 4.8% in 2025 to 4.1% in 2028. This implies that public spending on healthcare will remain below the target of 6% of GDP by 2027 set out in Latvia's 2021-2027 Public Health Policy Guidelines. The low level of public funding for healthcare limits its accessibility, leading to high waiting times, high levels of unmet needs and high out-of-pocket spending for healthcare. In relation to this, Latvia

^{(&}lt;sup>222</sup>) Update, with 2022 data, of analysis presented by Health at a Glance: Europe 2016 - © OECD 2016.

Table A14.1: Key health indicators

	2019	2020	2021	2022	2023	EU average* (latest year)
Cancer mortality per 100 000 population	292.6	296.5	283.6	280.0	n.a.	234.7 (2022)
Mortality due to circulatory diseases per 100 000 population	770.6	783.5	859.5	806.2	n.a.	336.4 (2022)
Current expenditure on health, purchasing power standards, per capita	1 436	1 563	2 110	1 928	n.a.	3 684.6 (2022)
Public share of health expenditure, % of current health expenditure	60.1	63.6	69.5	64.9	n.a.	81.3 (2022)
Spending on prevention, % of current health expenditure	2.6	3.1	5.1	2.8	n.a.	5.5 (2022)
Available hospital beds per 100 000 population**	423	416	406	394	n.a.	444 (2022)
Doctors per 1 000 population*	3.3	3.3	3.4	3.4	n.a.	4.2 (2022)*
Nurses per 1 000 population*	n.a.	n.a.	4.2	42	n.a.	7.6 (2022)*
Mortality at working age (20-64 years), % of total mortality	22.0	21.2	22.1	22.1	22.1	14.3 (2023)
Number of patents (pharma / biotech / medical technology)	0	2	3	2	2	29 (2023)***
Total consumption of antibacterials for systemic use, daily defined dose per 1 000 inhabitants****	13.9	11.9	11.6	15.0	14.9	20.0 (2023)

*The EU average is weighted for all indicators except for doctors and nurses per 1 000 population, for which the EU simple average is used based on 2022 (or latest 2021) data except for Luxembourg (2017). Doctors' density data refer to practising doctors in all countries except Greece, Portugal (licensed to practise) and Slovakia (professionally active). Density of nurses: data refer to practising nurses (EU recognised qualification) in most countries except France and Slovakia (professionally active) and Greece (hospital only). **'Available hospital beds' covers somatic care, not psychiatric care. ***The EU median is used for patents.

Source: Eurostat database; European Patent Office; ****European Centre for Disease Prevention and Control (ECDC) for 2023.

received a country-specific recommendation in 2024 to strengthen the adequacy of healthcare. Hospitals report that their allocated funding cannot cover either the growing demand for healthcare or the planned patient numbers, and signal that this will lead to postponed surgeries and increased waiting times. Under its recovery and resilience plan (RRP), Latvia aims to develop and implement new service models for healthcare in order to use health resources more efficiently.

Out-of-pocket payments account for a greater proportion of health spending in Latvia than the EU average. The largest share of out-ofpocket payments goes towards outpatient pharmaceuticals. To improve the affordability of medicines, Latvia expanded the list of reimbursable medicines, raised the level of public reimbursement and put in place a new pricing model as from 1 January 2025. This new model aims to incentivise pharmacies to sell more affordable medicines, imposes price caps on manufacturers (to align prices with those in Lithuania and Estonia) and only permits price changes once per year. Furthermore, copayments from patients for prescriptions will only be required when they start the treatment, with subsequent refills exempt from additional charges.

As regards public health, Latvia has scope to step up its efforts on disease prevention. The share of spending directed at prevention stood at 2.8% of total spending on health in 2022, much lower than the EU average of 5.5%. The rate of preventable mortality is among the highest in the EU, linked to a high prevalence of behavioural risk factors. Latvia is among the countries with the highest alcohol EU consumption, highest smoking rates, lowest consumption of fruit and vegetables, and lowest levels of physical activity outside working time. Latvia plans to strengthen health promotion and disease prevention with the support of the cohesion policy funds in 2021-2027. Furthermore, the Ministry of Health recently proposed an action plan for 2025-2029 to combat the rise of obesity. The plan includes: (i) public awareness campaigns; (ii) state-funded consultations for obese patients with nutrition specialists; and (iii) training for healthcare professionals. Several measures under Latvia's RRP also aim to improve the planning and implementation of public health policy, for example, the development of quidelines for epidemiologically safe healthcare, and studies in the areas of infectious diseases, vaccination and antimicrobial resistance.

While several investments and reforms supported by the Recovery and Resilience

Facility and the cohesion policy funds aim to improve the quality and adequacy of health services, access to healthcare remains limited. In 2023, the proportion of the Latvian population reporting unmet needs for medical care was significantly higher than the EU average (7.8% vs 2.4%) and had increased since 2022. The most recent data show a further increase to 8.4% in 2024. Such unmet needs are mainly due to financial reasons and waiting times, with lower income groups affected the most. The magnitude of differences between income groups in Latvia is among the highest in the EU. Furthermore, and specifically among people who declared having medical needs, the gap between people below and above the poverty threshold (defined as 60% of the median equivalised income) is higher in Latvia than the EU average. A range of measures under the RRP and the cohesion policy aim to improve health system accessibility. These include investments in: (i) hospital infrastructure and medical equipment; (ii) healthcare digitalisation; (iii) new service delivery models; (iv) setting up a network of hospitals specialising in the treatment and care of cancer patients; (v) developing and implementing recommendations for integrated care; and (vi) improving the provision of human resources for healthcare.

Latvia faces persistent shortages of health professionals, which hamper the provision of healthcare. The number of practising nurses per 1 000 population (4.2 in 2022) is one of the lowest in the EU. The Ministry of Health has estimated that the health sector has a shortfall of around 4 900 nurses. The number of doctors per 1 000 population is also below the EU average (3.4 vs 4.2 in 2022). Working conditions are a major deterrent to entering the national health service, especially low pay. A significant proportion of doctors (46.9%) and nurses (39.1%) are aged 55 and over, raising concerns about the long-term accessibility of health services. In 2024, Latvia received a country-specific recommendation to address labour and skills shortages in the health sector. Accordingly, the government approved a health workforce development strategy for 2025-2029, as part of Latvia's RRP. The strategy sets out to attract and retain staff in the national health service by creating better and more motivating working conditions, and by introducing new professions and roles, as well as new approaches to medical education (such as simulation training).

The potential of Latvia's health system to drive innovation and foster industrial development in the EU medical sector **remains largely untapped.** According to Eurostat data, Latvia does not report any specific public expenditure on health research and development. This is reflected in the very low number of European patents granted (only two in 2023, among the lowest in the EU) in the pharmaceuticals, combined areas of biotechnologies and medical technologies (²²³). Latvia also reports low clinical trial activity (²²⁴).

Latvia plans to accelerate the digitalisation of its health system, with support from EU programmes. The shares of individuals accessing their personal health records online or using online health services (excluding phone) instead of in-person consultations both increased in 2024 compared to 2020, although there is considerable room for further deployment. Investments to advance the digital transformation of Latvia's health sector are planned under the cohesion policy in 2021-2027. As part of Latvia's RRP, a digital health strategy running until 2029 was approved by the government. The strategy aims to improve the availability and interoperability of health data, and to boost the development and use of digital services in the health sector. The digitalisation of the health sector will also benefit from broader cross-sectoral investments in the national digital space under the RRP. Thanks to these investments, the national centralised envisaged data management platform will also be in a position

 ^{(&}lt;sup>223</sup>) European Patent Office, <u>Data to download | epo.org</u>.
 (²²⁴) EMA (2024), <u>Monitoring the European clinical trials</u>

environment, p. 9.

to provide access to healthcare datasets. The RRP also includes a specific investment to collect reference genome data from Latvian citizens as part of the European '1+ Million Genomes' initiative. The aim is to strengthen Latvia's genetic research and digital capacity. Furthermore, Latvia participates in the EU4Health-funded joint action TEHDAS2 (²²⁵), which aims to facilitate the implementation of the European Health Data Space.

^{(&}lt;sup>225</sup>) <u>Second Joint Action Towards the European Health</u> <u>Data Space – TEHDAS2 - Tehdas</u>
HORIZONTAL ANNEX 15: SUSTAINABLE DEVELOPMENT GOALS



This Annex assesses Latvia's progress on the **Development Goals** Sustainable (SDGs) along the dimensions of competitiveness, sustainability, social fairness and macroeconomic stability. The 17 SDGs and their related indicators provide a policy framework under the UN's 2030 Agenda for Sustainable Development. The aim is to end all forms of poverty, fight inequalities and tackle climate change and the environmental crisis, while ensuring that no one is left behind. The EU and its Member States are committed to this historic global framework agreement and to playing an active role in maximising progress on the SDGs. The graph below is based on the EU SDG indicator set developed to monitor progress on the SDGs in the EU.

Latvia is improving on SDGs related to

competitiveness (SDGs 4, 9) but needs to catch up with the EU average on SDGs 8 and 9. Latvia has low, albeit slowly increasing, gross domestic expenditure on R&D (SDG 9). In 2023, this stood at 0.82% of GDP (EU average: 2.24%). The share of households with a highspeed internet connection (SDG 9) was 71.4% in 2023, below the EU average of 78.8%. Sustainable economic arowth indicators (SDG 8) are below the EU average and moving away from the targets. The material footprint increased over the five years from 2018 to 2023, reaching 19.6 tonnes per capita in 2023 (EU average: 14.2 tonnes per capita). While Latvia is performing better than the EU average on general employment indicators, the level of fatal accidents at work stood at 2.98 accidents per 100 000 workers in 2022 (EU average: 1.66).



For detailed datasets on the various SDGs, see the annual Eurostat report '<u>Sustainable development in the European</u> <u>Union</u>'; for details on extensive country-specific data on the short-term progress of Member States: <u>Key findings –</u> <u>Sustainable development indicators – Eurostat (europa.eu)</u>. A high status does not mean that a country is close to reaching a specific SDG, but signals that it is doing better than the EU on average. The progress score is an absolute measure based on the indicator trends over the past five years. The calculation does not take into account any target values, as most EU policy targets are only valid for the aggregate EU level. Depending on data availability for each goal, not all 17 SDGs are shown for each country.

Source: Eurostat, latest update of 28 April 2025. Data refer mainly to the period 2018-2023 or 2019-2024. Data on SDGs may vary across the report and its annexes due to different cut-off dates.

Strengthening digital skills (SDG 4) remains a challenge, as only less than half of adults have at least basic digital skills (45.3% in 2023; EU average: 55.6%). Reforms and investment under the recovery and resilience plan (RRP) developing focus on further digital equipment infrastructure and and on improving digital skills at all levels.

While Latvia performs well (SDGs 2, 7, 14) or is improving (SDGs 9, 11, 12, 13) on several SDGs related to sustainability, it is moving away from its targets for SDG 6 and 15. Addressing SDG 7 (Affordable and clean energy) in particular, the share of renewable energy in total energy consumption increased from 40% in 2018 to 43.2% in 2023, and was well above the EU average (24.6% in 2023). Latvia's RRP includes measures to address some of the energy-related challenges, in both the REPowerEU chapter and Component 1 (Climate change and environmental sustainability). While Latvia is improving on SDG 13 (Climate action), it needs to catch up with the EU average, in particular on climate change mitigation. Net greenhouse gas emission from the land use, land-use change and forestry sector (LULUCF) increased to 71.7 tonnes CO₂ eq. per km² in 2023, it is far higher than the Latvian value five years earlier (-7.5 tonnes in 2018). Average CO₂ emissions from new passenger cars stand at 132.1 g CO₂ per km, well above the EU average of 107.6 g in 2023. Latvia is moving away from targets for SDG 6 (Clean water and sanitation) while the status is better than the EU average. In particular, the share of inland water bathing sites with excellent water quality has decreased from 87% in 2018 to 69.2% in 2023, the EU average being at 78.6%. Drought impact on ecosystems involves 10.7% of the country's area, while the EU average stands at 3.6% in 2023. On SDG 15 (Life on land), Latvia is moving away from its targets for the SDG. The share of forest area stands at 52.9% in 2022, well above the EU average of 38.7%. The biochemical oxygen demand in rivers was 1.36 mg O₂ per litre in 2022, well below the EU average of 2.73 mg O₂ per litre.

As regards the SDGs related to social fairness, Latvia performs well on indicators related to quality education (SDG 4) and affordable and clean energy (SDG 7), and is improving on indicators for no poverty (SDGs 1) and gender equality (SDG 5). At the same time, Latvia is moving away from the targets for SDG 3 (Good health and wellbeing), SDG 8 (Decent work and economic growth) and SDG 10 (Reduced inequalities), and needs to catch up with the EU average on these targets. While some indicators related to poverty (SDG 1) are improving, Latvia is still underperforming compared to the EU average. This concerns in particular the severe housing deprivation rate (11.6% in 2023; EU average: 4.0%) and people at risk of monetary poverty after social transfers (22.5% in 2023; EU average: 16.2%). As regards good health and well-being (SDG 3), Latvia is moving away from its targets and needs to catch up with the EU average. The share of people with good or very self-perceived health aood has not considerably improved over the years and stands at 47.6% of the population, compared to the EU average of 67.9% in 2023. Unmet need for medical care has increased over the years and stands at 7.8% of the population, compared to the EU average of 2.4% in 2023 Latvia is also underperforming compared to the EU average on SDG 10 (Reduced inequalities): the urban-rural gap for the risk of poverty or social exclusion accounted for 10.4% in 2023, (EU average: 0.2%) while purchasing power adjusted GDP per capita was 71 in 2024 (EU = 100). . The RRP includes measures to reduce regional disparities, improve the social safety net and encourage social integration and inclusion in Latvia. It also aims to contribute to the accessibility, efficiency and resilience of Latvia's health system.

Latvia is improving on the SDGs related to macroeconomic stability (SDGs 16, 17), but still needs to catch up with the EU average on SDGs 8 (Decent work and economic growth) and 16 (Peace, justice and strong institutions). In recent years, Latvia's real GDP per capita increased, going from EUR 15 820 in 2019 to EUR 17 510 in 2024 (EU average was EUR 33 530 in 2024). The investment share of GDP is above the EU average (24.9% of GDP, vs 22.4% for the EU in 2023). Latvia's performance on the quality of its institutions, including trust in institutions, is below the EU average but improving (SDG 16 on Peace, justice and strong institutions). The Corruption Perception Index in Latvia is 59, slightly below the EU average of 62 (score scale of 0 (highly corrupt) to 100 (very clean)). The RRP includes several measures to increase the transparency and integrity of public administration through training on general skills like ethics, integrity and anticorruption.

As the SDGs form an overarching framework, any links to relevant SDGs are either explained or depicted with icons in the other annexes.

ANNEX 16: CSR PROGRESS AND EU FUNDS IMPLEMENTATION



Latvia faces structural challenges in a wide range of policy areas, as identified in the country-specific recommendations (CSRs) addressed to the country as part of the European Semester. They refer, among other things, to taxation policy, social protection, reduction of inequalities, accessible healthcare, affordable housing, skills, education and training, and research and innovation. In addition, they cover investment in energy, renewables and energy efficiency, sustainable transport, digital infrastructure and access to finance.

The Commission has assessed the 2019-2024 CSRs considering the policy action taken by Latvia to date and the commitments in its recovery and resilience plan (RRP). At this stage, Latvia has made at least 'some progress' on 84% of the CSRs (²²⁶), and 'limited progress' on 12% (Table A16.2).

EU funding instruments provide considerable resources to Latvia by supporting investments and structural reforms to increase competitiveness, environmental sustainability and social fairness, while helping to address challenges identified in the CSRs. In addition to the EUR 1.969 billion funding from the Recovery and Resilience Facility (RRF) in 2021-2026, EU cohesion policy funds (227) are providing EUR 4.4 billion to Latvia (amounting to EUR 5.2 billion with national co-financing) for 2021-2027 (228) to boost regional competitiveness and growth. Support from these instruments combined represents around 16.3% of 2024

GDP (²²⁹). The contribution of these instruments to different policy objectives is outlined in Graphs A16.1 and A16.2. This substantial support comes on top of financing provided to Latvia under the 2014-2020 multiannual financial framework, which financed projects until 2023 and has had significant benefits for the economy and Latvian society. Project selection under the 2021-2027 cohesion policy programmes has accelerated, while significant volumes of investment are yet to be mobilised.

The Latvian RRP contains 63 investments and 25 reforms to stimulate sustainable growth and strengthen social protection, especially in the area of healthcare, education and skills. A year before the end of the RRF timespan, implementation is well on its way with 56% of the funds disbursed. At present, Latvia has fulfilled 38% of the milestones and targets in its RRP (²³⁰). Increased efforts are needed to ensure completion of all RRP measures by 31 August 2026. While the implementation of Latvia's RRP is well underway, challenges remain. Latvia from could benefit strengthening its administrative capacity improving and execution strategies to help mitigate delays administrative hurdles. **EU-funded** and construction projects are at risk of delayed delivery due to the construction sector's strained capacity, caused by competing demands, regulatory burden and external factors.

Latvia also receives funding from several other EU instruments, including those listed in table A16.1. Most notably, the common agricultural policy (CAP) provides Latvia with an EU contribution of EUR 2.4 billion under the CAP strategic plan for 2023-2027 (²³¹).

^{(&}lt;sup>226</sup>) 7% of the 2019-2024 CSRs have been fully implemented, 14% substantially implemented, and some progress has been made on 63%.

^{(&}lt;sup>227</sup>)In 2021-2027, cohesion policy funds include the European Regional Development Fund, the Cohesion Fund, the European Social Fund Plus and the Just Transition Fund. The information on cohesion policy included in this annex is based on adopted programmes with the cut-off date of 5 May 2025.

^{(&}lt;sup>228</sup>) European territorial cooperation (ETC) programmes are excluded from the figure.

^{(&}lt;sup>229</sup>) RRF funding includes both grants and loans, where applicable. GDP figures are based on Eurostat data for 2024.

^{(&}lt;sup>230</sup>) As of mid-May 2025, Latvia has submitted 3 payment requests.

^{(&}lt;sup>231</sup>)An overview of Latvia's formally approved strategy to implement the EU's common agricultural policy nationally

Furthermore, operations amounting to EUR 39 million (²³²) have been signed under the InvestEU instrument backed by the EU guarantee, improving access to financing for riskier operations in Latvia.

Graph A16.1:Distribution of RRF funding in Latvia by policy field



(1) Each RRP measure helps achieve the aims of two of the six policy pillars of the RRF. The primary contribution is shown in the outer circle, while the secondary contribution is shown in the inner circle. Each circle represents 100% of the RRF funds. Therefore, the total contribution to all pillars displayed on this chart amounts to 200% of the RRF funds allocated.

Source: European Commission

Graph A16.2: Distribution of cohesion policy funding across policy objectives in Latvia



Cohesion policy funds aim to increase the
productivity and competitiveness of Latvia's
firms and improve the business
environment.Description
environment

(²³²) Data reflect the situation on 31.12.2024.

Development Fund (ERDF) supports nearly 1 700 small and medium-sized enterprises in developing skills for smart specialisation, innovation and entrepreneurship. Latvia is the Strategic Technologies for leveraging Europe Platform (STEP) to boost its competitiveness, allocating EUR 57 million to STEP priorities focusing on clean and resourceefficient technologies, energy independence and renewable energy capacity. The European Social Fund Plus (ESF+) on the other hand, invests EUR 40.6 million in active labour market policies to improve the qualifications and skills of 44 000 unemployed people by 2029. An additional EUR 46.6 million from the ESF+ supports adult education, split between sectorbased programmes (EUR 17.2 million) and individual needs-based learning (EUR 29.4 million), targeting 48 000 employed and selfemployed people by 2029.

Other funds contributing are to competitiveness in Latvia, for instance through open calls. The Connecting Europe Facility has financed strategic investments in rail transport such as the Rail Baltica, the development of alternative fuel infrastructure in the air and maritime sectors, the integration of the market includina energy the synchronisation of the Baltic States with the EU's electricity system and in 5G connectivity along transport corridors, along Via Baltica. Horizon Europe has supported research and innovation, from scientific breakthroughs to gu innovations, with widenina scaling participation and spreading excellence and Climate, Energy and Mobility as top priorities in Latvia. The Technical Support Instrument (TSI) instance, supported the green for has, transition through developing technological solutions and production possibilities for sustainable aviation fuel (SAF). It also indirectly contributed to the reform of enhancing the digital transition in the Latvian RRP through an enhanced understanding of the competition issues of selected digital markets.

Latvia's	RRP	also	conta	ains	ambitious
measures	to	imp	rove	the	business

can be found at: <u>https://agriculture.ec.europa.eu/cap-my-</u> country/cap-strategic-plans/latvia_en

environment and competitiveness. As part of the measures covered by payment requests over the past year, major reforms and investments have been implemented aimed at fuelling economic growth. This includes, for instance, the award of contracts to develop four industrial parks across Latvia, aiming to boost regional growth by upgrading infrastructure, attracting businesses, and creating high-value jobs.

EU funds are playing a significant role in promoting environmental sustainability and green transition in Latvia during the current seven-year EU budget (multiannual financial framework). The ERDF is investing over EUR 76 million in systems for climate-related disaster prevention and resilience, as well as resource efficiency, creating an additional capacity of 80 000 tonnes a year for waste recycling. ERDF investments are also expanding renewable energy production capacity, thereby increasing the share of renewables in final energy consumption and reducing dependence on fossil fuels. Furthermore, the CAP strategic plan allocates EUR 299.6 million from rural development and EUR 439 million from direct payments to environmental and climate objectives. Six eco-schemes will support environmentally beneficial farming practices, including ecological focus areas and agroecological practices in organic farms. The plan aims to increase organic farming to 18.8% of Latvia's agricultural land by 2027, supported by agri-environmental schemes and other environmental measures under rural development funding.

Latvia's RRP, including the REPowerEU chapter, has a comprehensive set of reforms and investments for the green transition. Measures covered by the payment requests submitted over the last year include, among others, measures to upgrade the electricity grid and develop energy communities. This includes the entry into force of the necessary regulatory framework for a timely implementation of the REPowerEU chapter's investments, which will contribute to overall energy security in the country and to the resilience of electricity networks in the context of increasing needs for additional grid capacity and for grid flexibility.

Promoting fairness, social cohesion and improving access to basic services are among the key priorities of EU funding in Latvia. The ERDF support will provide access to new or modernised healthcare facilities for the majority of the Latvian population increasing the capacity of the healthcare system. It will also expand classroom capacity in education than 15 000 facilities by more places. Complementing ERDF infrastructure investments, Latvia's ESF+ allocates EUR 68 million to promoting social cohesion through deinstitutionalisation, developing communitybased and family-oriented care services for children and adults with a disability. The programme aims to set up over 250 service centres by 2029, supporting 2 800 individuals at risk of social exclusion.

Latvia's RRP contains several reforms and investments related to fairness and social policies. As part of measures covered by payment requests over the past year, Latvia has implemented reforms and investments in the fields of education and affordable housing. This includes agreements between the development finance institution Altum and real estate developers which will deliver more than 300 low-rent apartments across the regions, fostering affordable housing and enhancing labour mobility. Moreover, over 35,000 laptops have been provided to municipalities and schools, boosting educational guality and ensuring that students from socially vulnerable groups have access to digital solutions, enabling their participation in remote learning improving educational equity. and The Technical Support Instrument (TSI) has been supporting Latvia in contributing to a socially fair transition towards climate neutrality by addressing the social impacts of the inclusion of greenhouse gas emissions from buildings and road transport into the EU ETS by supporting Latvia to develop a Social Climate Plan.

Table A16.1: Selected EU funds with adopted allocation	s - summai	y data	(million EU	JR)
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Instrument/policy	Allocation	Disbursed since 2021 (1)		
RRF grants (induding the RepowerEU allocation)	196	1094.3		
REloans	()	0	
Instrument/policy	Allocation 2014-2020 (2)	Allocation 2021-2027	Disbursed since 2021 (3) (covering total payments to the Member State on commitments originating from both 2014- 2020 and 2021-2027 programming periods)	
Cohesion policy (total)	4 640.7	4 434.3	2 604.5	
European Regional Development Fund (ERDF)	2 665.8	2 565.5	1 477.9	
Cohesion Fund (CF)	1 246.6	956.2	670.9	
European Social Fund (ESF, ESF+) and the Youth Employment Initiative (YEI)	728.2	721.0	393.3	
Just Transition Fund (JTF)		191.6	62.5	
Fisheries				
European Maritime, Fisheries and Aquaculture Fund (EVFAF) and the European Maritime and Fisheries Fund (EVFF)	139.8	134.9	102.2	
Migration and home affairs				
Mgration, border management and internal security - AMF, BVM and ISF (4)	70.9	197 <u>.</u> 9	65.4	
The common agricultural policy under the CAP strategic plan (5)	Allocation 2023-2027		Disbursements under the CAP Strategic Plan (6)	
Total under the CAP strategic plan	2 409.1		715.1	
European Agricultural Quarantee Fund (EAGF)	172	22.1	631.4	
European Fund for Agricultural Development (EAFRD)	687.0		83.7	

(1) The cut-off date for data on disbursements under the RRF is 31 May 2025.

(2) Cohesion policy 2014-2020 allocations include REACT-EU appropriations committed in 2021-2022.

(3) These amounts relate only to disbursements made from 2021 onwards and do not include payments made to the Member State before 2021. Hence the figures do not comprise the totality of payments corresponding to the 2014-2020 allocation. The cut-off date for data on disbursements under EMFAF and EMFF is 29 April 2025. The cut-off date for data on disbursements under State Sta

(4) AMIF - Asylum, Migration and Integration Fund; BMVI- Border Management and Visa Instrument; ISF - Internal Security Fund.

(5) Expenditure outside the CAP strategic plan is not included.

(6) The cut-off date for data on EARDF disbursements is 5 May 2025. The information on EAGF disbursements is based on the Member State declarations until March 2025. Disbursements for the Direct Payments (EAGF) started in 2024. *Source:* European Commission

Table A16.2: Summary table on 2019-2024 CSRs

Latvia	Assessment in May 2025	Relevant SDGs
2019 CSR 1	Some progress	
Ensure that the nominal growth rate of net primary government expenditure does not exceed 3.5 % in 2020, corresponding to an annual structural adjustment of 0.5 % of GDP.	Not relevant anymore	SDG 8, 16
Reduce taxation for low-income earners by shifting it to other sources, particularly capital and property, and by improving tax compliance.	Some progress	SDG 8, 10, 12, 16
Ensure effective supervision and the enforcement of the anti-money laundering framework.	Substantial progress	SDG 8, 16
2019 CSR 2	Some progress	
Address social exclusion notably by improving the adequacy of minimum income benefits, minimum old- age pensions and income support for people with disabilities.	Some progress	SDG 1, 2, 8, 10
Increase the quality and efficiency of education and training in particular of low-skilled workers and jobseekers, including by strengthening the participation in vocational education and training and adult learning.	Some progress	SDG 4
Increase the accessibility, quality and cost-effectiveness of the healthcare system.	Some progress	SDG 3
2019 CSR 3	Some progress	
Focus investment-related economic policy on innovation,	Some progress	SDG 9, 10, 11
the provision of affordable housing,	Some progress	SDG 1, 2, 8, 10, 11
transport, in particular on its sustainability,	Some progress	SDG 10, 11
resource efficiency and energy efficiency, energy interconnections	Some progress	SDG 6, 7, 9, 10, 11, 12, 13
and digital infrastructure, taking into account regional disparities.	Some progress	SDG 9, 10, 11
2019 CSR 4	Some progress	
Strengthen the accountability and efficiency of the public sector, in particular with regard to local authorities and State-owned and municipal enterprises and the conflict of interest regime.	Some progress	SDG 9, 16
2020 CSR 1	Some progress	
Take all necessary measures, in line with the general escape clause of the Stability and Growth Pact, to effectively address the COVID-19 pandemic, sustain the economy and support the ensuing recovery. When economic conditions allow, pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.	Not relevant anymore	SDG 8, 16
Strengthen the resilience and accessibility of the health system including by providing additional human and financial resources.	Some progress	SDG 3
2020 CSR 2	Substantial progress	
Provide adequate income support to the groups most affected by the crisis	Substantial progress	SDG 1, 2, 10
and strengthen the social safety net.	Some progress	SDG 1, 2, 10
Mitigate the employment impact of the crisis, including through flexible working arrangements,	Full implementation	SDG 8
active labour market measures and skills.	Some progress	SDG 4, 8
2020 CSR 3	Some progress	
Ensure access to liquidity support by firms and in particular small and medium-sized enterprises	Substantial progress	SDG 8, 9
Front-load mature public investment projects	Some progress	SDG 8, 16
and promote private investment to foster the economic recovery.	Some progress	SDG 8, 9
Focus investment on the green and digital transition, in particular on research and innovation,	Limited progress	SDG 9
clean and efficient production and use of energy,	Some progress	SDG 7, 9, 13
sustainable transport	Some progress	SDG 11
and digital infrastructures.	Substantial progress	SDG 9
2020 CSR 4	Substantial progress	
Continue progress on the anti-money-laundering framework.	Substantial progress	SDG 8, 16

(Continued on the next page)

Table (continued)

2021 CSR 1	Not relevant anymore			
In 2022, maintain a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment. Keep the growth of nationally financed current expenditure under control.	Not relevant anymore	SDG 8, 16		
When economic conditions allow, pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term.	Not relevant anymore	SDG 8, 16		
At the same time, enhance investment to boost growth potential. Pay particular attention to the composition of public finances, on both the revenue and expenditure sides of the budget, and to the quality of budgetary measures, in order to ensure a sustainable and inclusive recovery. Prioritise sustainable and growth-enhancing investment, in particular investment supporting the green and digital transition.	Not relevant anymore	SDG 8, 16		
Give priority to fiscal structural reforms that will help provide financing for public policy priorities and contribute to the long-term sustainability of public finances, including, where relevant, by strengthening the coverage, adequacy, and sustainability of health and social protection systems for all.	Not relevant anymore	SDG 8, 16		
2022 CSR 1	Limited progress			
In 2023, ensure that the growth of nationally financed primary current expenditure is in line with an overall neutral policy stance, taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. Stand ready to adjust current spending to the evolving situation.	Not relevant anymore	SDG 8, 16		
Expand public investment for the green and digital transitions, and for energy security taking into account the REPowerEU initiative, including by making use of the Recovery and Resilience Facility and other Union funds.	Not relevant anymore	SDG 8, 16		
Pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions.	Not relevant anymore	SDG 8, 16		
Broaden taxation, including of property and capital,	Limited progress	SDG 8, 10, 12		
and strengthen the adequacy of healthcare	Limited progress	SDG 3		
and social protection to reduce inequality.	Some progress	SDG 1, 2, 10		
2022 CSR 2				
Proceed with the implementation of its recovery and resilience plan, in line with the milestones and targets included in the Council Implementing Decision of 13 July 2021.	RRP implementation is monitored by assessing RRP payment requests and analysing reports published twice a year on the achievement of the milestones and targets. These are to be reflected in the country reports.			
Submit the 2021–2027 cohesion policy programming documents with a view to finalising their negotiations with the Commission and subsequently starting their implementation.	Progress on the cohesion policy programm cohesio	ning documents is monitored under the EU n policy.		
2022 CSR 3	Some progress			
Improve access to finance for small and medium-sized enterprises through public lending and guarantee schemes aimed at facilitating investments of strategic importance, in particular the green transition and regional development	Some progress	SDG 8, 9		
2022 CSR 4	Some progress			
Reduce overall reliance on fossil fuels and diversify imports of fossil fuels	Some progress	SDG 7, 9, 13		
by accelerating the deployment of renewables,	Some progress	SDG 7, 9, 13		
ensuring sufficient interconnection capacity, diversifying energy supplies and routes	Substantial progress	SDG 7, 9, 13		
and reducing overall energy consumption through ambitious energy efficiency measures.	Some progress	SDG 7		
2023 CSR 1	Some progress			
Wind down the emergency energy support measures in force, using the related savings to reduce the government deficit, as soon as possible in 2023 and 2024. Should renewed energy price increases necessitate new or continued support measures, ensure that such support measures are targeted at protecting vulnerable households and firms are fiscally affordable and preserve incentives for energy savings.	Substantial progress	SDG 8, 16		
Ensure prudent fiscal policy, in particular by limiting the nominal increase in nationally financed net primary expenditure in 2024 to not more than 3,0 %.	No progress	SDG 8, 16		
Preserve nationally financed public investment and ensure the effective absorption of grants under the Facility and of other Union funds, in particular to foster the green and digital transitions.	Full implementation	SDG 8, 16		
For the period beyond 2024, continue to pursue a medium-term fiscal strategy of gradual and sustainable consolidation, combined with investments and reforms conducive to higher sustainable growth, in order to achieve a prudent medium-term fiscal position.	Some progress	SDG 8, 16		
Broaden taxation, including of property and capital, and	Limited progress	SDG 8, 10, 12		
strengthen the adequacy of healthcare and	Limited progress	SDG 3		
social protection.	Some progress	SDG 1, 2, 10		
2023 CSR 2				
Continue the steady implementation of its recovery and resilience plan and swiftly finalise the REPowerEU chapter with a view to rapidly starting the implementation thereof. Proceed with the speedy implementation of cohesion policy programmes, in close complementarity and synergy with the recovery and resilience plan.	RRP implementation is monitored through the assessment of RRP payment requests and analysis of the bi-annual reporting on the achievement of the milestones and targets, to be reflected in the country reports. Progress with the cohesion policy is monitored in the context of the Cohesion Policy of the European Union.			
2023 CSR 3	Some progress			
Improve access to finance for small and medium-sized enterprises through public lending and guarantee schemes aimed at facilitating investments of strategic importance, in particular in the areas of the green transition and regional development.	Some progress	SDG 8, 9		

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ANNEX 17: COMPETITIVE REGIONS

Latvia's regional economic landscape presents both significant challenges and emerging opportunities for development. While substantial disparities exist between the capital region and other areas, several regions show promising growth trajectories based on a mix of traditional sectors like wood processing, food production and manufacturing of electronics and pharmaceuticals, alongside emerging sectors such as information technology and electronics.

Map A17.1: GDP per head (in purchasing power standard), NUTS 3, 2022



GDP per capita varies significantly between Latvian regions. In 2022, the capital region of Rīga had a GDP per capita the EU average (100), reaching 109%. This was more than double the GDP per capita of all other NUTS 3 regions in Latvia. In 2022, GDP per capita in the other NUTS 3 regions ranged from 34% of the EU average in the easternmost region, Latgale (which is also a border region, bordering both Belarus and Russia), to 51% in Pierīga (Map A17.1) Between 2013 and 2023, GDP per head in Vidzeme and Rīga grew annually at a rate of 4.6% and 2.8% respectively. Kurzeme (2.2%) and Pierīga, estimated at 2.4%, registered the lowest growth rate over the same period. Latgale remains disadvantaged both in terms of GDP per capita and moderate growth of GDP.

Competitiveness

Regional competitiveness in Latvia is strongly influenced by labour productivity patterns, which reveal both challenges and opportunities for economic convergence. While all regions currently perform below the EU average in productivity (measured as GDP per hour worked), there are notable variations in performance. The capital region Rīga (71%) and Pierīga (84%) show relatively strong productivity levels, approaching EU averages and exceeding the average for less developed EU regions (64%). This suggests potential for knowledge spillovers to other regions. However, the significant productivity gap between these leading regions and areas like Latgale (36%) points to untapped potential for productivity gains through targeted investments in technology, skills and innovation capacity. Addressing these productivity differences would help boost regional competitiveness and ensure more balanced economic development across Latvia.

The quality of the government in Latvia – as measured by the European Quality of Government Index at the subnational level – is below the EU average, and regions have limited fiscal autonomy. The Quality of Government Index (²³³) has improved since 2010, driven by improvement in all its subcomponents (corruption, quality and impartiality of public services). The planning (NUTS 3) regions, however, have limited fiscal

^{(&}lt;sup>233</sup>)European Quality of Government Index 2024 University of Gothenburg

	GDP (PPS)	GDP per head (PPS)	Real GDP growth	Real GDP per head growth	Productivity - GDP per person employed (PPS)	Real productivity growth (per person employed)	Productivity - GDP per hour worked (PPS)	Real productivity growth (per hour worked)	Net migration
	million	Index EU-27 = 100	Average annual % change	Average annual % change	Index EU-27 = 100	Average annual % change	Index EU-27 = 100	Average annual % change	Average annual net crude migration rate (%)
	2022	2022	2014-2023	2014-2023	2022	2013-2022	2022	2013-2022	2014-2023
European Union (27 MS)	15905280	100	1.7	1.6	100	0.7	100	0.9	3.2
Latvia	48497	69	2.4	3.1	66	2.0	64	2.6	-1.3
Kurzeme	4061	50	0.9	2.2	59	1.1	56	2.6	-5.5
Latgale	2891	34	1.6	3.3	36	1.6	36	0.7	-6.0
Rīga	23133	109	2.2	2.8	74	1.2	71	1.6	-1.6
Pierīga	6959	51	2.9	2.4	88	2.8	84	5.2	7.7
Vidzeme	3058	48	3.3	4.6	57	3.2	55	5.0	-5.8
Zemgale	3548	45	3.0	4.1	56	2.8	54	3.2	-3.8

Table A17.1: Selection of indicators at regional level in Latvia

autonomy and administrative capacity - their revenue depends heavily on earmarked government transfers. This lack of fiscal autonomy affects the capacity of local governments to plan and implement investments. Increasing tax autonomy and reducing the percentage of earmarked transfers (i.e. better multi-level governance) would improve the planning regions' capacity (²³⁴). to attract investment Positive developments in local governance include improving the local population's ability to participate in decision-making. The right to hold municipal referendums as of autumn 2024 and the new 'participatory budgets' for citizen projects in municipalities (mandatory from 2025) as of 2025 could improve the quality of governance and civic engagement in the regions.

There is lack of access to finance in Latvia's lagging regions (Latgale, Kurzeme, Vidzeme and Zemgale). There is a very weak uptake of financial instruments (such as guarantees) supported by cohesion funding (channelled via

(²³⁴) OECD (2025): Rethinking Regional Attractiveness in the Region of Latgale, Latvia.

Altum, the national promotional institution), particularly in Latgale. Enterprises in the regions are not prepared to take up more sophisticated financial products. This creates obstacles to business investment. Offering financial literacy workshops for businesses could help reduce information gaps.

differences Significant socio-economic between urban and rural areas persist in employment and skills. People living in rural areas have on average a lower level of educational attainment. While Latgale, home to Daugavpils University and the Rezekne Academy of Technology, has a strong higher education offer, this has not translated into greater post-secondary educational attainment for its population. Cooperation between higher education institutions and employers would help address skills gaps and develop a strong regional proposition for investors in high value added sectors. Also, it would be helpful to develop targeted regional programmes to attract and retain talent (²³⁵).

^{(&}lt;sup>235</sup>)OECD (2025): Rethinking Regional Attractiveness in the Region of Latgale, Latvia.

Latvia faces significant transport challenges, with limited access to and within some of its lagging regions, which significantly hampers their attractiveness. Latgale's road density is the second lowest in the country, sitting among the 2% of EU regions with the lowest road density (measured by km per km²). Also rail transport performance in the region is poor, resulting in the lowest rail accessibility in Latvia(²³⁶), and putting it in the bottom 8% of all EU regions. More attention could be paid to developing strong foundations for businesses to thrive by providing good infrastructure, such as road and railway connections. In particular, improving the regional connectedness of the lagging regions (notably to Rīga) for businesses, talent and visitors would help strengthen their attractiveness and competitiveness (237).

Rural regions are also lagging behind in innovation, as illustrated by patent applications data. Patent applications to the European Patent Office per million inhabitants were nearly 10 times higher in Rīga and Pierīga than in the (rural) rest of the country. Latgale registers fewer EU trademark patents per capita than 93% of EU regions. High-tech patent applications per million inhabitants stood at 1.1 in 2012, lower than the national average of 3.2 and significantly lower than the EU average of 17.4. All of these are clear signs of lack of innovative activity in Latvia's lagging regions, in particular Latgale (²³⁸).

With GDP per capita at just 34% of the EU average and despite a growth rate above the Latvian average, Latgale is struggling to catch up. These economic challenges are amplified by poor transport connectivity. The region also faces depopulation and ranks among the lowest performing regions in the EU for innovation and patent activity. However, recent NATO activities and the new action plan for the eastern border of Latvia (2025-2027) could boost R&D and regional development, particularly in dual-use goods and infrastructure (²³⁹).

The recent focus on eastern border regions, and Latgale in particular, thanks to a number of projects could offer significant development opportunities. In this context, the national action plan to develop the eastern border of Latvia from 2025 to 2027 lays down policy priorities for the first time and identifies specific funding for the region, acknowledging the special challenges for this EU external border region. The EU, together with partners, has also stepped up support to address more structural underdevelopment challenges. The OECD's project 'Rethinking regional attractiveness in the region of Latgale' analyses the economic and tourism potential of the region as it undergoes a difficult transition away from the Russian and Belarussian markets. The World Bank's 'Catching-up regions initiative' is being implemented in all Baltic countries and aims to develop practical project pipelines that will boost the local economy in Latgale.

Social fairness

Latvian regions are experiencing rapid depopulation. Between 2014 and 2023 the Latvian population decreased by 6.7% (²⁴⁰). In three regions (Kurzeme, Vidzeme and Latgale) the population has fallen by more than 10% since 2013. The biggest loss was observed in Latgale (-17.1%). In Rīga the population decreased by 5.7%, whereas the population in

^{(&}lt;sup>236</sup>) The rail indicators capture the % of population within a 120 km radius that can be reached in 90 minutes, as developed by Eurostat

^{(&}lt;sup>237</sup>)OECD (2025): Rethinking Regional Attractiveness in the Region of Latgale, Latvia.

^{(&}lt;sup>238</sup>) OECD (2025): Rethinking Regional Attractiveness in the Region of Latgale, Latvia.

^{(&}lt;sup>239</sup>) OECD (2025): Rethinking Regional Attractiveness in the Region of Latgale, Latvia

^{(&}lt;sup>240</sup>) Average annual change per 1000 residents.

the surrounding region of Pierīga increased by 5.9%.

Significant disparities exist between urban and rural areas in Latgale in providing (public) services. There are major differences in the quality and level of public services. The absence of common standards for public services across local governments results in uneven service quality, further driving depopulation in rural areas, where local budgets are generally lower (World Bank, 2024). Although the 2020 administrative territorial reform has helped optimise local government budgets, significant differences in budget allocation and debt levels persist.

Table A17.2: Socio-economic indicators by degree of urbanisation, 2024

	Cities	Towns and suburbs	Rural areas
Population with high educational attainment (% of population aged 25-64)	48.1	44.4	29.9
Early leavers from education and training (% of population aged 18-24)	4.4	7.7	11.4
NEET: Neither in employment nor in education or training (% of population 15-34)	10.8	12.3	14.3
At-risk-of-poverty or social exclusion (% of total population)	19.3	23.3	29.4
Housing cost overburden (% of total population)	7.6	7.2	5.7

Source: Eurostat

Lack of access to housing in the regions undermines regional competitiveness efforts. Businesses and municipalities in Latvia's rural regions view lack of housing as a serious obstacle to attracting skilled workers who require quality modern housing (²⁴¹). The construction of new dwellings as a proportion of the housing stock is lowest in Latgale – in 2024, only 3.3% of all new housing in Latvia was constructed in Latgale, compared to 75% of new builds in Rīga (²⁴²). The key reason

concerns access to finance: those wishing to settle in regions more than 100 km from Rīga face difficulties obtaining mortgages, even with a sufficient and stable income (as the saving rate in Latvia is one of the lowest in the EU). Latgale has the lowest rate of mortgages, standing at less than 2% of municipal GDP in 2023, compared to over 30% in the Rīga metropolitan area. Conversely, the region has considerably higher interest rates for mortgages than Rīga and other regions (²⁴³). In 2023, around 9% of the population in Latvian cities were living in a household affected by housing cost overburden (244), while the corresponding rate for rural areas with a majority of private houses was 5.5%. So, while housing expenses are lower in Latvia's lagging regions than in Rīga and surroundings, housing conditions seem less favourable in the rural regions (such as Latgale). Expanding the range of rental housing providers (for example through municipalities playing a more active role) or initiatives like the Housing Affordability Fund could help to increase rental options as well as affordable housing (245). An RRP pilot project for affordable rental housing in the regions aims to attract more private investment in this sector, but more focused efforts would accelerate and increase the scale of housing investments in the regions.

Sustainability

The green energy transition and the associated increase in renewables offer unique opportunities for less developed

^{(&}lt;sup>241</sup>) Latvia's Plan 2024-2027 for implementation of Housing Accessibility Guidelines (2024).

⁽²⁴²⁾ Central Statistics Bureau of Latvia, 2024, <u>Ekspluatācijā pieņemto jauno dzīvokļu skaits reģionos,</u> valstspilsētās un novados – Ēku veids, Laika periods un <u>Teritoriālā vienība. PxWeb.</u>

^{(&}lt;sup>243</sup>) Central Bank of Latvia (2024), Access to Finance Overview, <u>Finanšu Pieejamības Pārskats 2024.</u>

^{(&}lt;sup>244</sup>) The housing cost overburden rate is the percentage of the population living in households where the total housing costs ('net' of housing allowances) represent more than 40% of disposable income ('net' of housing allowances).

⁽²⁴⁵⁾ OECD (2025): Rethinking Regional Attractiveness in the Region of Latgale, Latvia.

regions, particularly for their rural areas. However, while Latvia is a beacon for foreign direct investment in renewable energy, there is currently a moratorium within 80 km of the eastern border. This largely prevents the lagging region of Latgale from benefiting from investment in renewables, notably wind (²⁴⁶).

In 2023, the untapped potential of solar, wind and hydro power in the Latvian regions was large, positioning all regions, except the capital region of Rīga, in the 10% bottom of all EU regions. At 5.6%, Latvia's green employment in sustainable sectors shows considerable room for expansion, particularly when compared to the EU average of 15.1%. In 2022, access to alternative fuel infrastructure, at 43.15 (247), was above the average of less developed regions (29), but still far from the EU average (287) (²⁴⁸). Latgale, like most non-capital Latvian regions (except Pierīga), has much room for improvement in green transport, with hybrid and electric vehicles comprising only 0.1% of the region's fleet, well below the EU average of 2.6% (²⁴⁹).

^{(&}lt;sup>246</sup>) OECD (2025): Rethinking Regional Attractiveness in the Region of Latgale, Latvia.

⁽²⁴⁷⁾Measured as number of electric vehicle charging points within 10 km.

^{(&}lt;sup>248</sup>) Indicators of access to alternative fuel infrastructure are based on calculations by DG REGIO and the JRC, using data from the European Alternative Fuels Observatory (EAFO), Eurostat, TomTom and Eco-Movement.

⁽²⁴⁹⁾ OECD (2025): Rethinking Regional Attractiveness in the Region of Latgale, Latvia.