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**Agenda 2000 - Commission Opinion on Latvia's
Application for Membership of the European Union**

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A. INTRODUCTION

a) Preface

The Application for Membership

Latvia presented its application for membership of the European Union on 13 October 1995, and the Council of Ministers decided on 30 October 1995 to implement the procedure laid down in Article 0 of the Treaty, which provides for consultation of the Commission.

That is the framework in which the Commission submits the present Opinion, responding to the request of the European Council in Madrid in December 1995 to present the Opinion as soon as possible after the conclusion of the Intergovernmental Conference, which commenced in March 1996 and concluded in June 1997.

The Context of the Opinion

The Latvian application for membership is being examined at the same time as applications from nine other associated countries. Latvia's accession is to be seen as part of an historic process, in which the countries of Central and Eastern Europe overcome the division of the continent which has lasted for more than 40 years, and join the area of peace, stability and prosperity created by the Union.

The European Council in Copenhagen in June 1993 concluded that:

“The associated countries in Central and Eastern Europe that so desire shall become members of the Union. Accession will take place as soon as a country is able to assume the obligations of membership by satisfying the economic and political conditions. Membership requires:

- that the candidate country has achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
- the existence of a functioning market economy, as well as the capacity to cope with competitive pressure and market forces within the Union;
- the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.

The Union's capacity to absorb new members, while maintaining the momentum of European integration, is also an important consideration in the general interest of both the Union and the candidate countries”.

This declaration spelled out the political and economic criteria for examining the accession requests of the associated countries of Central and Eastern Europe.

The European Council in Madrid in December 1995 referred to the need, in the context of the pre-accession strategy, “to create the conditions for the gradual, harmonious integration of the applicant countries, particularly through:

- the development of the market economy,
- the adjustment of their administrative structure,
- the creation of a stable economic and monetary environment”

In its Opinion, the Commission analyses the Latvian application on its merits, but according to the same criteria as the other applications, on which it is delivering Opinions at the same time. This way of proceeding respects the wish, expressed by the European Council in Madrid, to ensure that the applicant countries are treated on an equal basis.

In addition to the individual Opinions the Commission is presenting separately to the Council, in the framework of its communication “Agenda 2000”, a general assessment of the accession requests, and its recommendations concerning the strategy for successful enlargement of the Union. At the same time, it is presenting an evaluation of the impact of enlargement on the Union’s policies.

The Contents of the Opinion

The structure of the Opinion takes account of the conclusions of the European Council in Copenhagen. It:

- describes the relations up to now between Latvia and the Union, particularly in the framework of the association agreement;
- analyses the situation in respect of the political conditions mentioned by the European Council (democracy, rule of law, human rights, protection of minorities);
- assesses Latvia’s situation and prospects in respect of the economic conditions mentioned by the European Council (market economy, capacity to cope with competitive pressure);
- addresses the question of Latvia’s capacity to adopt the obligations of membership, that is the *acquis* of the Union as expressed in the Treaty, the secondary legislation, and the policies of the Union;
- makes finally a general evaluation of Latvia’s situation and prospects in respect of the conditions for membership of the Union, and a recommendation concerning accession negotiations.

In assessing Latvia in respect of the economic criteria and its capacity to assume the *acquis*, the Commission has included a prospective assessment; it has attempted to evaluate the progress which can reasonably be expected on the part of Latvia in the coming years, before accession, taking account of the fact that the *acquis* itself will continue to develop. For this purpose, and without prejudging the actual date of accession, the Opinion is based on a medium-term time horizon of approximately five years.

During the preparation of the Opinion, the Commission has obtained a wealth of information on Latvia's situation from the Latvian authorities, and has utilised many other sources of information, including the member states and numerous international organisations.

b) Relations between the European Union and Latvia

Historical and Geopolitical Context

With a territory of some 64 000 sq. km, and a population of 2.5 million, Latvia lies on the Eastern coast of the Baltic sea and shares borders with Estonia in the North, Russia and Belarus in the East and Lithuania in the South. The Baltic Sea connects Latvia also with Sweden, Finland, Germany and Denmark. This location has traditionally made Latvia an important transit route between Europe and Russia, notably during the period of the Hanseatic League.

In 1201, German Teutonic knights conquered Latvia. Subsequently, Latvia came under Lithuanian, Polish, and Swedish rule until, partly in 1704 and fully in 1772, it was annexed by Russia.

After the first World War, Latvia proclaimed its independence on November 18, 1918 and successfully defended it against the Soviet Union. A period of parliamentary democracy in the 1920s was followed by an authoritarian regime in 1934. During the period between the two World Wars, the country experienced considerable economic growth and an improvement in its standard of living. Latvia was forced to grant military bases to the Soviet Union in September 1939, and the country was annexed by the Soviet Union in June 1940. It was occupied by Germany in 1941-44.

After the war Soviet rule was re-established, though not recognised by most Western States. It was accompanied by mass deportations and settlement of Russians. In 1988 a Popular Front for Latvia was formed, and in 1989 it won the elections to the Supreme Council, which the following year declared Latvia still independent. In 1990 and 1991 there were violent clashes between supporters of independence and Latvian communists and Soviet forces. A referendum in March 1991 voted 73% in favour of independence, which was declared on 21 August 1991 and recognised by the Soviet Union the following month. Russian military forces withdrew from the country in 1994, though there is still a Russian radar station at Skrunda, under agreed OSCE supervision.

Latvia's Position Concerning the European Union

Since regaining independence in August 1991, Latvia has followed a consistent foreign policy strategy of European integration. All parties in the present government see further European integration and full membership of the EU as the main priority. This was confirmed by the declaration by all parties in Parliament in October 1995, in which the parties supported the Government's decision to submit its application for EU Membership.

The determination to achieve membership in the EU as well as the commitment to undertake any necessary preparations were most recently presented by President Ulmanis on 4 May 1997 on the occasion of Latvia's Declaration of Independence Day:

“We are preparing ourselves for the accession negotiations with the European Union. We see it as a two-sided process: firstly, the conformity of the model of state, economy and society with the principles of the EU. Efficient and purposeful operation of the Latvian administrative system is very important in this process. However, it will be only partially successful if we neglect the other, the central aspect. Each resident of Latvia should be able to see himself in the perspective of Latvia as the future member of the EU. Therefore, we must intensify the explanation of the EU principles

throughout Latvia and - in the context of popularising the idea of Europe - we should consolidate our national self-awareness.

The opening of the EU and the idea of the unity of Europe is the strategy of our common development and Latvia is a stable member of it.”

Contractual Relations

Diplomatic relations between the European Communities and Latvia were established on 27 August 1991. A Trade and Cooperation Agreement was signed on 11 May 1992 and entered into force in 1993. The present contractual relationship between the EU and Latvia is regulated by a Free Trade Agreement which was signed on 18 July 1994 and entered into force on 1 January 1995. This preferential agreement aims at establishing free trade between the EU and Latvia within a transitional period lasting a maximum of four years, on a basis of asymmetry. Some sectors (mainly textiles, agricultural products and fisheries) are regulated by specific rules. The Agreement also contains provisions concerning payments, competition and approximation of legislation.

A Europe Agreement was negotiated between the European Communities and Latvia in the first half of 1995 and signed on 12 June 1995. Latvia ratified the Agreement on 31 August 1995. It will enter into force on completion of ratification by all EU Member States. The Europe Agreement will then replace the Trade and Cooperation Agreement as well as the Free Trade Agreement.

Once it enters into force, the Europe Agreement will be the legal basis for relations between Latvia and the Union. Its aim is to provide a framework for political dialogue, promote the expansion of trade and economic relations between the parties, provide a basis for Community technical and financial assistance, and an appropriate framework to support Latvia's gradual integration into the Union. The institutional framework of the Agreement provides a mechanism for implementation, management and monitoring of all areas of relations. Sub-committees examine questions at a technical level.

The Association Committee, at senior official level, provides for discussion of and often solutions to problems arising under the Europe Agreement. The Association Council, at Ministerial level, examines the overall status of and perspectives for relations and provides the opportunity to review Latvia's progress on preparation for accession.

To pursue its European integration activities, Latvia has established a European Integration Council consisting of the main Ministers concerned which meets every month to coordinate the implementation of the National Programme for Integration into the EU. The Minister of European Union Affairs has the day-to-day responsibility for co-ordinating the European Union policies and has the European Integration Bureau (EIB) under his responsibility. The EIB is the focal point for proposals for and implementation of integration initiatives. It is supported by 23 technical working groups. A Parliamentary Commission of European Affairs ensures political coordination of the integration process.

The Pre-Accession Strategy

Implementation of the Free Trade Agreement and the White Paper

The measures envisaged in the Agreement between Latvia and the European Community are being implemented according to the agreed timetable. Over the last two years, the Joint Committee, the Interparliamentary Committee and the sectoral Working Groups have all met regularly. Pending adoption of an Additional Protocol (under preparation), autonomous measures have been adopted for agricultural products, processed agricultural products, textiles and fisheries, in order to adapt the Free Trade Agreement to the latest enlargement of the Union as well as to the conclusion of the Uruguay Round. Implementing rules on undertakings and state aid are under preparation. A new Protocol on rules of origin entered into force on 1 April 1997 allowing for pan-European cumulation of rules of origin. Discussions are currently going on regarding the extension of Protocol 1 on trade in textiles beyond the expiry date of 31 December 1997. Agreement on the determination of the agricultural component applicable to products originating in the Community in accordance with Protocol 2 is also close to being reached.

Other main issues being discussed in the context of the Free Trade Agreement are: approximation of legislation and pre-accession strategy, macro-economic progress, Latvia's relations with its neighbouring states, opening of community programmes, customs cooperation, certification and standardisation issues and trade issues.

The Commission's White Paper of 1995 on the Internal Market set out the legislation which the candidate countries would need to transpose and implement in order to apply the *acquis*, and identified elements essential to the implementation of the single market (known as Stage I measures) which would need priority attention. Latvia has attached considerable importance to this work. The Latvian *National Programme for EU Integration* was adopted by the Government of Latvia in December 1996 as the general strategy for the pre-accession phase, and as a response to the White Paper. The Latvian Programme includes time-tables and responsibilities for each legislative field. The programme has been approved in the Parliament's Committee for European Affairs.

The scope of the legislative programme so far is mainly Stage I legislation. The Latvian approach will gradually be widened to cover other legislative fields, in particular transport, the environment, consumer protection and labour-market issues. The National Programme will be up-dated every six months in order to allow for clear priorities to be set and to ensure rapid progress of the integration process. Progress in legislative alignment has been achieved in the areas of company law, customs legislation, free movement of capital (including liberalisation of right to buy property), indirect taxation and procurement procedures.

Overall the EC/Latvia Free Trade Agreement is functioning well. It has been possible to resolve any problems arising in a smooth and productive manner. Cooperation has already advanced further in some sectors than the Agreement requires. This provides a good basis for the enhanced level of cooperation and implementation which will be required under the Europe Agreement.

Structured Dialogue

Latvia has participated in the Structured Dialogue since the Cannes European Council in June 1995. Latvia has been an active participant, especially in the political dialogue. In March 1997, Latvia tabled a proposal for the development of an individualised political dialogue.

Phare

EU technical and financial assistance to Latvia commenced under the 1991 TACIS programme and has been extended under Phare since 1992. During the period 1992-1996, the Phare programme allocated 124 MECU to Latvia. The allocation for 1997 is 38 MECU. Principal sectors have been: reform of the legal and institutional framework; infrastructure development; restructuring and privatisation. It has had a particular impact on privatisation of enterprises and land, and on tax administration and customs.

There is also a growing emphasis on cross-border cooperation programmes, especially for transport and environment.

Participation in Community Programmes

Latvia has indicated that, once the Europe Agreement has entered into force, it would like to participate in Socrates, Leonardo, Youth for Europe, MEDIA II and Life beginning in 1998, and SAVE, Kaleidoscope and Raphael as from the following year.

Trade Relations

Latvia was almost exclusively dependent on trade with the former Soviet Union at the time of the re-gaining of independence in 1991. But the EU accounted in 1996 for approximately 45% of exports (Germany 14%, UK 11% and Sweden 7%), while the Russian share represented 23%. The EU share of all imports amounted to 50% in 1996. Following the entry into force of the Free Trade Agreement between the EU and Latvia and the accession of Finland, Sweden and Austria, EU exports to Latvia increased by 29% from 1994 to 1995, while imports from Latvia increased by 18%.

EU imports from Latvia are mainly wood products and textiles, while EU exports to Latvia consist mainly of machinery and electrical equipment and chemicals.

Trade with its Baltic neighbours, Estonia and Lithuania, is modest but developing, following a free trade agreement which regulates trade in industrial products with these countries. Latvia has been an active participant in Baltic cooperation, both in the different cooperation structures that exist between the three Baltic states and in a wider context through the Council of the Baltic Sea States. Latvia is also considering membership in the Central Europe Free Trade Agreement (CEFTA).

General Evaluation

Relations with the EU have developed well since Latvia regained its independence. No delays are foreseen to establishing free trade in industrial goods by 1999, as foreseen by the Free Trade Agreement. The various subjects and issues dealt with under the Free Trade Agreement have been discussed and solved effectively. Cooperation will be further enhanced when the Europe Agreement with Latvia enters into force.

B. CRITERIA FOR MEMBERSHIP

1. Political Criteria

The European Council in Copenhagen decided on a number of “political” criteria for accession to be met by the candidate countries in Central and Eastern Europe. These countries must have achieved “stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities”.

In carrying out the assessment required in this connection, the European Commission has drawn on a number of sources of information: answers given by the Latvian authorities to the questionnaire sent to them by Commission staff in April 1996, bilateral follow-up meetings, reports from Member States’ embassies and the Commission’s delegation, assessments by international organisations (including the Council of Europe and the OSCE), reports produced by non-governmental organisations, etc.

The following assessment involves a systematic examination of the main ways in which the public authorities are organised and operate, and the steps they have taken to protect fundamental rights. It does not confine itself to a formal description but seeks to assess the extent to which democracy and the rule of law actually operate.

This assessment relates to the situation in June 1997. It does not examine in detail any changes which have taken place since the fall of the Communist régime or which may come about in the future, though it generally takes account of any stated intention to reform a particular sector. The situation of the government is mentioned here only in passing: it will be examined in greater depth in chapter 4.

1.1 Democracy and the Rule of Law

When Latvia regained its independence in August 1991, it declared the primacy of the old Constitution of 1922 over all laws in force in the country. After various amendments designed to establish parliamentary democracy, the Constitution was restored in its entirety in 1993. In the meanwhile, an ordinary parliamentary act of 1991 enumerated the rights and obligations of the citizen. The Latvian institutions work smoothly, the various authorities being mindful of the limits of their powers and of the need for cooperation.

Parliament and Legislative Powers: Structure

Parliament consists of a single house - the Saeima. 100 members are elected for 3 years by proportional representation on the basis of a list at national level (with a minimum threshold raised from 4% to 5% in 1995). There are no arrangements for specific representation of minorities.

The right to dissolve Parliament is subject to an original procedure. The President of the Republic can put the dissolution of the Saeima to a referendum. If the referendum produces a majority of votes in favour of the President’s proposal, the Saeima is dissolved and elections are called within 2 months (Article 48 of the Constitution). If the proposal is rejected, the President is then deemed to have resigned and is replaced (Article 50).

Under Article 28 of the Constitution, MPs enjoy a traditional array of immunities except as regards any defamatory remarks made during debates in the Saeima. The role and involvement of the opposition in the working of the institutions is recognised in Latvia. It has a voice for example in the setting up of parliamentary committees of enquiry (set up by 1/3 of the members of the Saeima). Two such committees were recently set up on the use of certain loans granted by the G 24 and the privatisation of two Latvian banks.

The existence of numerous political groupings (38 officially registered to date) bears witness to the fact that Latvia is genuinely a multiparty State. While the creation of parties may appear straightforward, “non-nationals” have no right to form parties (for example the formation of a party called the “Latvia Stateless League” was banned). Political parties receive no funding from the State.

Legislative power lies with Parliament. Legislation may be initiated by the President, the Government and at least 10% of the electorate, as well as by Parliament. The President has the right to demand a second reading in Parliament but has to bow to the Saeima’s wishes if it confirms its initial vote without amendment. The President invoked this right for example before the passing of the 1994 Nationality Act. The Government has the power to make regulations conferred on it either by legislation or where there is an absence of legislation. Furthermore, under Article 81 of the Constitution, it may pass acts with the force of legislation should an emergency arise during a Parliamentary recess. However, such acts may in no circumstances relate to the electoral system, the organisation and procedures of the judicial system, the budget, amnesty or the taxation system and are deemed invalid unless they are presented to Parliament within 3 days of the resumption of parliamentary proceedings.

A referendum procedure is enshrined in the Latvian constitution. On the initiative of either the President of the Republic or a third of the members of the Saeima, an act passed by Parliament can be suspended in order to be put to a referendum at the request of one tenth of the electorate. The suspended act will, however, become law if, within 2 months, the threshold of 10% of the electorate required to hold a referendum has not been reached or the act is put to the vote once again by the Saeima and passed by a majority of 3/4 of its members. Under Article 73 of the constitution, the referendum procedure may not be applied to the budget, taxation and customs duties, military service, declarations of war, peace treaties, state of emergency, mobilisation and international treaties.

Functioning of Parliament

The 1992 and 1995 elections took place in free and fair conditions. In both cases, they resulted in the formation of coalition governments (see Annex: results of 1995 elections).

Parliament operates satisfactorily. Its powers are respected and the Opposition plays a full part in its activities.

The Executive: Structure

The President of the Republic, who is elected by Parliament for a three-year term, which may be renewed only once, is also accountable to the Saeima, which has the power to dismiss him by a 2/3 majority of its members either on political grounds (Article 51 of the Constitution) or on grounds of criminal activity (Article 54). He exercises the powers traditionally conferred on the Head of State.

The Government is accountable to the Saeima. The President of the Republic designates the Prime Minister, who appoints the ministers. The number of ministers is fixed by law (12 at present). The ministers are also individually accountable to Parliament.

Latvia has not introduced any intermediate levels of government. The Government is therefore obliged to negotiate directly with each local authority concerning the contents of decisions which affect it.

Latvia has some 594 local authorities, which fall into one of two types: districts (26) and municipalities, the latter breaking down into metropolitan (7), urban (70) and rural municipalities (491). Each local authority has a Council elected by direct universal suffrage. The role of the districts is to coordinate measures taken by the municipalities in the planning and management of local public services. The Saeima can dissolve the elected body of each local authority and the minister for the environment and regional development can introduce legislation overruling any decisions of a local authority which might be incompatible with the Constitution, the law or a Government decree. The right of appeal before the courts exists in such cases.

Civil service regulations have been in force since 1994. Civil servants' salaries are very low and the attraction of salaries in the private sector is behind the departure of some of the most able senior civil servants for positions in private industry.

The army, the secret services and the police are controlled by the civilian authorities. The army is still experiencing disciplinary problems and its morale remains relatively low. The secret services are controlled by the "Office for the Protection of the Constitution", which coordinates the activities of all the services concerned.

Functioning of the Executive

The central institutions of the State operate smoothly.

The local authorities appear to enjoy a reasonable measure of autonomy, particularly in financial matters, subsidies granted by central government being negotiated with each local authority. A major debate is currently taking place in Latvia concerning a number of issues relating to local autonomy: reduction of the number of municipalities (more than 400 of them have less than 2000 inhabitants), method of electing the regional councils, redefinition of the allocation of resources between central and local government, incorporation of local administrators in the national civil service, control of local finance.

Latvia has launched a vigorous programme of civil service reform: establishment in 1993 for a two-year period of a Ministry for Central Government Reform, preparation of civil service regulations and a programme to combat corruption in 1994, establishment the same year of a National Civil Service College. Despite these efforts, the situation remains difficult and any improvement continues to require a major programme of training and the establishment of institutions to oversee the implementation of civil service reforms. The present government has made the fight against corruption one of its priorities.

The secret services are subject to control by Parliament through a "Committee on national security".

The Judiciary: Structure

The separation of the Latvian judiciary from the other powers appears secure. Judges are appointed by the Minister of Justice and their appointments are confirmed by Parliament after two years' professional practice. From then on, they have absolute security of office, which can only be called into question if they have committed a crime. The judges at the Supreme Court are appointed by the President of that body. Latvia has no specialised courts but the ordinary courts all have lawyers responsible for handling specific types of cases (administrative, civil, criminal). The judges are not subject to any pressure from the Government.

The Chief Prosecutor is elected for 7 years by Parliament on the proposal of the President of the Supreme Court. He is totally independent of the Minister of Justice.

The compatibility of decrees and acts of the President of the Republic, the Government and local authorities with the Constitution and the law is subject to the judicial review of the Constitutional Court while in other cases judicial review is exercised by the ordinary courts.

The role traditionally assigned to an Ombudsman is among the many functions fulfilled by the National Human Rights Office set up in July 1995. It is responsible for handling complaints, including those concerning the private sector, proposing such amendments to legislation or regulations as it sees fit and informing the public about human rights. More particularly, it has the task of overseeing the protection of the most vulnerable social groups (children, the handicapped etc.) and may, of its own initiative, conduct any investigation it regards as appropriate in the field of the protection of human rights. It is completely independent from the Government and reports to the Saeima.

The Constitutional Court, which was set up in June 1996, consists of 7 judges elected for 10 years by an absolute majority of the members of the Saeima (3 are nominated by Parliament, 2 by the Government and 2 by the Supreme Court). It verifies the constitutionality of primary legislation, treaties and secondary legislation. Matters may be referred to the Constitutional Court by the President of the Republic, the Government, 1/3 of the members of the Saeima, the Chief Prosecutor or even a local authority. However, the courts and the citizen may not apply to it directly.

Functioning of the Judiciary

Considerable improvements are needed in the workings of the judicial apparatus in order to reduce the time taken to judge cases. The judicial system is also somewhat inefficient as regards the enforcement of decisions taken by the courts. This is attributable either to the lack of appropriate instruments (bailiffs do not exist in Latvia) or to lack of authority particularly over certain public bodies (for example occasional failure of the body responsible for managing the naturalisation system - to implement decisions taken concerning it by the courts in this area).

The National Human Rights Office plays an essential role in ensuring respect for fundamental rights in Latvia. It enjoys real independence from the other public authorities as illustrated for example by its investigation of the differences in status between citizens and non-citizens in Latvia (December 1996).

1.2 Human Rights and the Protection of Minorities

Latvia has introduced various internal rules designed to ensure respect for human rights and minorities' rights. Such respect may also be guaranteed by the application of certain international conventions, foremost among which is the European Convention for the Protection of Human

Rights and its main additional protocols. Under Article F of the TEU, observance of human rights forms part of the *acquis*: any State wishing to join the European Union must first have ratified these texts.

In June 1997, Latvia, which has been a member of the Council of Europe since February 1995, ratified the European Convention for the Protection of Human Rights and most of the additional protocols (with the exception of Protocol No 6 on capital punishment). It also permits individuals to take their case to the European Court if they consider that their rights under this convention have been violated.

Among the other main conventions protecting human rights and minority rights, Latvia has signed but not ratified the framework convention on minorities and the European Social Charter. It has not signed the convention on the prevention of torture but is now working in that direction. By contrast, it has ratified the main human rights conventions concluded in the framework of the United Nations.

Under Latvia's Law on international treaties, these take precedence over the law once they have been ratified.

Civil and Political Rights

Access to the courts is unrestricted in Latvia. An act of April 1993 enshrines the right of every individual to the services of a lawyer free-of-charge at all stages of the procedure. However, owing to a shortage of qualified lawyers, this is difficult to apply outside Riga.

Although still not abolished in Latvia, capital punishment was suspended by the President of the Republic in September 1996.

The right not to be arbitrarily arrested appears secure. Arrest warrants are now issued by a judge and, since 1994, no longer by the Public Prosecutor. No individual may be held by the police for questioning for more than 72 hours, after which the Public Prosecutor must either prefer charges or release the person detained. The maximum period of remand is 18 months.

Everyone aged 18 years or over has the right to vote.

Freedom of association is guaranteed, as shown by the vitality of Latvia's civil society (1700 non-governmental organisations in 1995, 2400 in 1996). There are many associations devoted to protecting the rights and interests of non-nationals despite the fact that non-nationals may not form political parties.

Freedom of assembly is established.

Freedom of expression is well established in Latvia as can be seen from the proliferation of the press and audio-visual media (2000 newspapers and magazines, 25 radio stations, 41 television stations including two national public stations and one private one). Censorship is banned (1991 Act for the press, 1995 Act for the audio-visual media). The political parties enjoy unrestricted access to the media.

The right of ownership is guaranteed in Latvia except for non-nationals. Properly registered foreigners have the right to acquire land if the States of which they are nationals have concluded agreements on the mutual protection of investments. Latvia has introduced arrangements for the return to the former owners of property of which they had been dispossessed by the Communist regime. More than 70% of claims for the return of property have now been processed. Latvia is moreover engaged in a review of its land register, which should be completed by 2005.

Respect for privacy is ensured by the need to obtain a warrant from the judicial authorities before property can be searched or postal or telephone communications can be monitored.

The position of asylum-seekers should improve with the forthcoming adoption of an act governing the status of such people in Latvia. It should afford asylum-seekers greater access to justice than they enjoy at present and prevent a repeat of the conditions which existed at the Olaine accommodation centre until December 1996. This new act should also enable Latvia shortly to ratify the Geneva Convention of 1951.

A number of cases of inhuman and degrading treatment have been recorded in the prisons, the army and the asylum-seekers' accommodation centres (see above). In the prisons, adolescents are not always kept separate from adults and are held in poor sanitary conditions. The opening in 1996 of Latvia's first detention centres specifically intended for adolescents may mark the beginning of an improvement.

Economic, Social and Cultural Rights

All inhabitants of Latvia, whether they have Latvian nationality or not, have the right to the minimum means of subsistence.

The right to social security is also recognised.

Freedom to belong to a trade union is guaranteed except in the armed forces. Pluralism is demonstrated by the existence of 109 registered trade unions. More than half of the country's employees are represented by two large federations. Around 30% of wage-earners are members of a trade union in Latvia.

The right to strike is recognised in the private sector but does not extend to the civil service, the police, judges or members of the armed and security forces.

Free access to education is available to all.

Freedom of religion is based on the 1995 Act laying down the separation of Church and State. It provides that only registered denominations are entitled to various benefits and rights. So far, 800 have completed the registration formalities with the Ministry of Justice. Only the Jehovah's Witnesses were refused registration because of the rules which the members of this religion follow in the field of health care. This decision has been attacked in the courts. The investigation of the 1995 bomb outrage against the Riga synagogue has still not produced any significant results.

Minority Rights and the Protection of Minorities

In any assessment of the situation of the minorities in Latvia, a distinction has to be made between rights and safeguards connected with membership of an ethnic and cultural community regardless of the nationality held and differences in personal status arising from non-possession of Latvian nationality.

In Latvia, minorities, including non-citizens, account for nearly 44% of the population, including 30% Russians, 4% Belarusians and 3% Ukrainians. Latvians are a minority in 7 of the country's 8 largest towns. Within that 44%, 28% of the population, i.e. some 685 000 people, do not have Latvian citizenship and a large proportion of that group, consisting of former citizens of the USSR, have no citizenship at all. The present situation is largely attributable to the Soviet Union's post-1945 policy of encouraging the settlement of Russian-speakers (1935 census: 75.5% Latvians and

12% Russians; 1959: 62% Latvians and 26.6% Russians; 1979: 53.7% Latvians and 32.8% Russians).

The Act of August 1994 laid down various conditions for the acquisition of Latvian citizenship:

1. The right to apply for naturalisation is governed by a criterion of age. More precisely, the population is divided up into various age brackets, each of which is entitled to apply during a specific year, applications from persons in the last of these brackets only being accepted in 2003.
2. The acquisition of citizenship depends on passing an examination where the applicant must demonstrate his/her knowledge of the Latvian language and a certain knowledge of the country's history, its national anthem and its institutions.
3. Far, this system has not served to grant Latvian nationality to very many people, a fact which suggests that a large proportion of the country's population may remain foreigners for a long time to come. Since the start of the naturalisation procedure in February 1995, around 4700 people have acquired Latvian nationality. (April 1997).

In 1995-1996, some 93 000 people could have applied for it under the age-brackets arrangement. 7170 did so during those two years. The National Human Rights Office has been instructed to carry out an inquiry into the reasons for this phenomenon.

This situation may be attributable to a variety of factors. The relative difficulty of the tests may be one of the reasons and the Latvian authorities have already taken steps to lower the level of knowledge required. This factor could well explain the difficulties encountered particularly by the elderly. However, Latvia has introduced language-training programmes for Russian-speakers to help them prepare for the examination. The Phare programme has been providing support for these activities since 1996.

The system of age brackets, initially devised as a way of preventing the administration from being overwhelmed by a flood of applications, has had an inhibiting effect. Given this "shortage" of applications for naturalisation, such a system no longer appears warranted. Furthermore, the examination enrolment fees are still high.

In some cases, non-possession of Latvian citizenship may have appeared as an advantage, which may also help to explain the low number of naturalisation applications: no military service obligation, ease of travel to the countries of the former USSR thanks to the old Soviet passport etc.

Faced with this situation, the present government has undertaken to increase the number of naturalisations in the years to come so as to reduce the foreign portion of the Latvian population but without changing the existing law on citizenship.

The Latvian authorities must consider ways to make it easier for stateless children born in Latvia to become naturalised, so that the European Convention on Nationality concluded by the Council of Europe can be applied as soon as possible.

As regards the position of “non-citizens”, the 1995 Act conferred a clearer status on stateless people, and the issue of special passports to them, which should be completed by the end of 1997, already represents a considerable step forward, particularly from the point of view of their freedom of movement.

Nonetheless, “non-citizens” continue to be affected by various types of discrimination. They are barred from certain occupations. While some of these bars are not unusual (for example in the case of civil service posts where duties have a bearing on national sovereignty), others are far less comprehensible (private detectives, lawyers, airline crews, fire-fighters, pharmacists). In its above-mentioned study of December 1996, the National Human Rights Office observes that 10 of the differences in status between citizens and foreigners are contrary to the Latvian Constitution and the United Nations Convention on Civil and Political Rights. However, the Latvian Government has undertaken to abolish these instances of discrimination and a first legislative step in this direction was taken at the beginning of 1997.

In addition, “non-citizens” cannot directly acquire ownership of land and have no right to vote, even in local elections, even though that would be a powerful factor for encouraging integration. Lastly, some of their fundamental rights are less well protected; they are, for example, excluded from the scope of the 1995 amnesty law. These differences will have to be reduced, particularly while the foreign portion of the population of Latvia remains so large.

As regards the more general situation of the Russian-speaking minority (regardless of whether they possess Latvian citizenship or not), their rights are respected and protected even if some problems still have to be resolved. Moreover, there are no major problems in relations between the Latvians and the Russian minority.

The minorities have no special parliamentary representation. However, a Consultative Council of the Nationalities set up in July 1996 brings together representatives of 11 ethnic minorities and is responsible for monitoring the situation and proposing necessary reforms. On the cultural level, the Association of National Cultural Societies, which spans some twenty organisations, strives to promote tolerance and good relations between the various communities.

As regards the use of national languages, this is permitted in the courts if all the parties agree. Otherwise, the party concerned is entitled to the services of an interpreter. However, some obstacles exist for those who have no command of Latvian: need to know Latvian to receive unemployment benefit, obligation to pass a high-level language test to be able to stand for election.

In the education field, Latvia has two parallel education systems, one in Latvian and one in Russian, both financed by the State. Eight other minorities have state-aided schools in their national language. The 1995 amendment of the Education Act introduced the obligation for schools to increase the number of lessons taught in Latvian. However, its implementation is being hampered by the lack of teaching staff with the qualifications necessary to give such courses in schools serving the minorities. In higher education, students have to pass a test in Latvian before being admitted. However, a number of private establishments provide high-quality teaching in Russian.

In this area, the main criticism concerns the fact that Latvia has not yet introduced legislation on education for the minorities which would provide a solid framework for approaching this matter and planning for the medium term. This sort of situation provokes some fears amongst the minorities concerning the permanence of the measures currently taken by the public authorities to promote their educational establishments.

1.3 General Evaluation

Latvia's political institutions function properly and in conditions of stability. They respect the limits on their competences and cooperate with each other. Elections in 1992 and 1995 were free and fair, and in each case permitted the establishment of coalition governments. The Opposition plays a normal part in the operation of the institutions. Efforts to improve the operation of the judicial system and to intensify the fight against corruption need to be sustained.

There are no major problems over respect for fundamental rights. But Latvia needs to take measures to accelerate naturalisation procedures to enable the Russian-speaking non-citizens to become better integrated into Latvian society. It should also pursue its efforts to ensure general equality of treatment for non-citizens and minorities, in particular for access to professions and participation in the democratic process.

With the reservation that steps need to be taken to enable the Russian-speaking minority to become better integrated into society, Latvia demonstrates the characteristics of a democracy, with stable institutions guaranteeing the rule of law and human rights.

2. Economic Criteria

In examining the economic situation and prospects of Latvia, the Commission's approach is guided in particular by the conclusions of the European Council in Copenhagen in June 1993, which stated that membership of the Union requires "the existence of a functioning market economy, as well as the capacity to cope with competitive pressure and market forces within the Union".

This chapter of the Opinion therefore gives a concise survey of the economic situation and background, followed by a review of Latvia's progress in key areas of economic transformation (liberalisation of the price and trade system, stabilisation of the economy, structural change, reform of the financial sector) as well as its economic and social development. It concludes with a general evaluation of Latvia in relation to the criteria mentioned by the European Council and a review of prospects and priorities for further reform.

2.1 The Economic Situation

Background

Latvia, with a population of 2.5 million, has a gross domestic product (GDP) of ECU 8 billion (expressed in purchasing power parity); its population is about 0.7% of that of the Union, while its economy is only about 0.1%. GDP per head is about 18% of the Union average. The average monthly wage is about ECU 170 (November 1996).

Latvia has applied for membership of the WTO and expects to accede during 1997.

Progress in Economic Transformation

In the inter-war period, Latvia was an independent state, and highly integrated in the world economy. In 1940, the country was forcibly annexed by the Soviet Union and subsequently central planning was introduced. Relatively large and sophisticated industries were established in Latvia, because of its comparatively well-developed infrastructure. Latvia became totally dependent on the Soviet Union, both for inputs and for selling finished products. As the economy was relatively efficient, Latvia was the richest republic of the former Soviet Union. However, as in the rest of the Soviet Union, economic growth declined steadily over the years.

Although Latvia undertook some economic reforms during the *perestroika* era under Soviet rule, the fact that it regained independence only in 1991 has delayed the start of reforms. The country has had to face the difficult task of rebuilding a market economy and, at the same time, re-establishing the institutions of an independent state. The speed of reforms has not been equal in all areas: while price liberalisation and the building of a new tax system had started before independence, and while foreign trade, wages and interest rates were liberalised immediately afterwards, privatisation advanced much more slowly, particularly in industry. In 1995, the country suffered a severe banking crisis, which had knock-on effects on the budget. Although this dented the recovery in output, Latvia's inflation record has remained relatively good and GDP has started expanding again.

Until the late 1980s, Latvia was a pure command economy, without a significant private sector. Small-scale privatisation, and privatisation in the agricultural sector, are now almost complete, but progress with the sale of the big industrial enterprises has been slow. The share of the private sector in GDP had increased to 50% in 1995 while in employment it had risen to 62%.

Foreign Direct Investment

Since independence, foreign direct investment (FDI) has been relatively limited. It did improve in 1994, when net inflows were equal to 4.2% of GDP, the second-highest ratio of all associated countries in transition. As a percentage of GDP, FDI was slightly lower in 1995 and again in 1996, but the amounts in ecus increased. Between 1989 and 1996, FDI totalled ECU 467 million (source: EBRD). Investment came mainly from Denmark, Russia, the USA, Germany, the UK and Sweden, and was almost completely concentrated in the services sector (transport and communication, banking).

Economic Structure

Agriculture remains relatively important with a 9.9% share in gross value added in 1995 and an employment share of 18.5%. The sector plays a role as an employment buffer. As a result of privatisation and restructuring, the agricultural sector is largely made up of widely dispersed individual farms with little equipment and low productivity. Efficiency gains in food processing are limited by the lack of capital and management skills in both farms and enterprises. Nearly half of the agricultural land is occupied by family farms with an average size of 20 hectare. About one third of the land consists of much smaller plots and is used for part-time farming for own consumption. Government support to the sector has been reduced sharply during transition. The lack of budgetary resources, the extension of free trade with the neighbouring Baltic countries, and integration in the WTO will further expose the sector to market forces and enforce restructuring.

In 1996, **industry** as a whole accounted for about one quarter of GDP, and manufacturing for more than one fifth. Industry has not only shrunk since independence, but its composition has changed. Currently, the only areas which are growing are wood and pulp production, textiles and food processing. Under the Soviet regime the main areas were machine building, electronics and light industries. The linkage and dependence on the Soviet Union is indicated by the fact that prior to independence, every second motorcycle, every fifth radio, and every eighth washing machine that were used in the entire USSR were produced in Latvia. The large-scale enterprises were completely integrated with the Soviet industry and depended on cheap supply of raw materials and energy from other republics. After the disintegration of the Soviet Union, Latvian industry lost its access to cheap inputs because Russia started to charge world market prices; demand for Latvian products plunged, so output declined rapidly. Recent indicators show that industrial output has started to grow again from the low level to which it had fallen, but overall growth is slow and the conversion process from producing finished products for Soviet markets to producing higher-quality products for western markets is still going on.

Under the Soviet regime, **services** such as tourism and financial services were typically under-developed. Consequently, output in the services sector declined less than in agriculture or industry, and its share in total gross value added increased rapidly from 32% in 1990 to 57% in 1995. Now transport and communication is the biggest services sector, and provides currently for the largest part of GDP growth.

Main indicators of economic structure (all data for 1996 unless otherwise indicated)		
Population	million	2.5
GDP per head	PPS-ecu (1995)	3200
as % of EU-15 average	per cent (1995)	18
Share of agriculture in:		
gross value added	per cent (1995)	9.9
employment	per cent (1995)	18.5
Gross foreign debt/GDP	per cent	8
Exports of goods and services/GDP	per cent (1995)	47
Stock of foreign direct investment	ECU billion (1989-1996)	0.47
	ECU per head	167
* FDI stock converted at end-1996 exchange rate, 1 ECU= \$1.25299		
Source: Commission services, national sources, EBRD		

Liberalisation

Price Regime

Price liberalisation started in early 1991. Goods and services with administered prices still represent about 20% in the basket of the consumer price index. Prices for energy supply, utilities, transport and rents are still administered and do not cover full costs. Although cost coverage is increasing, full coverage is only envisaged for the year 2005. This gradual adjustment of administered prices will continue for a number of years and will contribute to inflation. Regulatory bodies have been set up for basic telecommunication services and energy prices to find a proper balance between producer and consumer interests.

Trade Regime

After independence, Latvia built up a very liberal trade regime. Quantitative restrictions and export tariffs have been almost completely removed. Import tariffs range from 1% or less for raw materials, inputs and products not produced in Latvia, to 20% for most other finished goods. However agriculture goods continue to be highly protected, with an average production-weighted tariff rate of more than 50%.

The vast majority of imports are subject to free trade agreements or have MFN status. The government is committed to reducing the peak tariffs, but hesitates to do so in the face of the negotiations for WTO accession.

Latvia has reached free trade agreements with EFTA countries, has applied for membership of the WTO (expected in 1997) and is considering applying for CEFTA-membership. It also has a number of other bi-lateral agreements. Since 1 April 1996, a free trade agreement with its Baltic neighbours, Estonia and Lithuania, is in force. On 1 January 1997, this agreement was extended to trade in agricultural products. The objective is to establish a full customs union at a later stage.

Foreign Exchange Regime

The introduction of the new national currency, the lat, was done in two steps. First, the Russian rouble was replaced by the Latvian rouble in 1992, which was allowed to float freely. When the Latvian rouble was considered strong enough, the lat was gradually introduced, starting from March 1993, becoming the sole legal tender from October 1993. After a period of managed floating, when it was allowed to appreciate in nominal terms, it was pegged to a basket of currencies (the IMF's Special Drawing Rights basket) in February 1994. The regime was chosen to provide a nominal anchor which would facilitate business planning and bring down inflation. It has been fairly successful in achieving its objectives to date. The currency is fully convertible. Latvia accepted the obligations of Article VIII of the IMF from 10 June 1994, so there are no exchange restrictions on current account transactions.

Almost all restrictions on capital movements have been abolished. Since December 1996, the purchase of rural land by foreigners is less restricted (except for Latvia's "non-citizens"). A similar law relating to urban land ownership has been passed in early 1997. Legal entities, registered in the State Enterprise Register, in which Latvian citizens and foreign nationals from countries with which Latvia has agreements on mutual protection of investment have a majority stake, are now free to buy land in Latvia.

Stabilisation of the Economy

Domestic

The first three years of independence were marked by a dramatic output decline: by the end of 1993 real GDP had halved compared to 1990. The transition from a command to a market economy, and, even more importantly, the end of the close input and output relations with the Soviet Union, provoked a crisis in industry and agriculture. The decline seemed to have ended in 1994, but the incipient recovery was interrupted in 1995. Largely due to the uncertainties related to the banking and budget crises, real GDP in 1995 declined by 1.6%. GDP growth turned positive again in 1996, when it is estimated to have been 2.8%. It can be expected to accelerate further in the coming years, if investment increases and the required restructuring takes place.

Rapid price liberalisation and loose monetary policy pushed up the inflation rate high into the three digit range in 1992. As monetary policy was tightened, inflation fell sharply in 1993 to around 35%, and declined gradually afterwards reaching 8.8% in April 1997. Inflation is likely to remain in high single digits for some time as administered prices are adjusted to cover costs fully.

Unemployment increased sharply after the start of the reforms, and it has only slightly decreased since 1994. As the restructuring of industrial enterprises continues, a further increase in unemployment over the coming years cannot be excluded, but it is more likely that unemployment will be further reduced as a result of the growth of the services sector.

Main economic trends		1994	1995	1996
Real GDP growth rate	per cent	0.6	-1.6	2.8
Inflation rate				
annual average	per cent	35.9	25	17.6
December	on per cent	26.2	23.2	13.2
Unemployment rate, end-year	per cent ILO	-	18.9	18.3
General government budget balance	per cent of GDP	-4.4	-3.4	-1.8
Current account balance	per cent of GDP	5.5	-0.4	-9.8
Debt/export ratio	per cent	19.9	19.5	18.6
Foreign direct investment	per cent of GDP	4.2	3.9	3.6
Source: Commission services, national sources, EBRD				

After a period with marked fluctuations between deficits and surpluses, the government budget has been in deficit since 1994. The deficit ran up to 3.4% of GDP in 1995, significantly higher than originally planned. It was because of low tax revenue, as a result of negative economic growth, widespread tax evasion, growing tax arrears and poor tax administration, and because the low revenue was not sufficiently offset by expenditure cuts. The financing of the deficit was made more difficult and costly by the banking crisis as the market for Treasury bills collapsed and interest rates rose. The problem was only in central government, as the social security fund, local government, and other extra-budgetary funds were all in surplus. The government has since successfully tackled the problem by cutting expenditure and improving tax collection; the 1996 budget deficit only reached 1.8% of GDP, and in 1997 the budget should be balanced.

External

In 1995, for the first time since the start of transition, exports rose in real terms. Nevertheless, the foreign trade deficit increased further, since imports grew faster than exports. The trade deficit in 1996 was very high, at 18% of GDP. This was, however, largely offset by the positive balance on transit trade and services.

Latvia has rapidly built up foreign exchange reserves, which by 1993 already covered 4.5 months of imports. However, the speculation against the currency during the banking crisis, and increased imports, meant the import coverage dropped during 1995, after which it stabilised. At the end of 1996, foreign exchange reserves stood at 358.5 million lats (ECU 514 million or 3.5 months of imports). The external debt ratio remains low and was less than 10% of GDP in 1995.

Structural Change

Foreign Trade

After regaining independence, export and import shares fell back from 50% of GDP to around 30% and 48% respectively in 1996. It also led to trade reorienting to western markets to a significant extent. While trade relations outside the Soviet Union used to be almost non-existent, in 1996 they represented over 50% of exports and 65% of imports. Although in 1996, Russia was still Latvia's main trading partner accounting for 23% of exports, the importance of Germany (14%), the United Kingdom (11%), and Sweden (7%) had increased significantly. The total EU share of exports was 44%.

The composition of trade also underwent dramatic changes. Before the start of transition, machinery and equipment was the most important export category, representing around 28% of total exports. By 1996 its share had fallen to only 14%. Similarly, the share of food products declined from around 22% to 12.5%. On the other hand, the share of wood and wood products increased from some 3% to as much as 24.2%, and is now the most important export category.

These remarkable shifts illustrate that Latvia has competitive advantage in generally low-value-added areas. Its post-war industries have not been able to penetrate western markets. On the import side, the shares of textiles and machinery and equipment were approximately halved, while mineral products gained importance and became the biggest import category. Latvia is heavily reliant on energy imports. As the product categories that represent the highest shares in exports (wood and wood products, textiles, and food products) have also experienced the fastest export growth, export commodity concentration has increased, making the economy more vulnerable to external shocks. Consumer goods account for a relatively high share of imports (22%) given the level of development, which suggests that the quality of locally produced goods is inferior.

Labour Market

Registered unemployment has stabilised at between 6 and 7% of the active population. These figures do not adequately capture the extent of unemployment: the labour force survey carried out in 1995 indicated that 19% of the active population were looking for work and ILO figures suggest unemployment rates of around 18%. The proportion of long-term unemployed has increased rapidly and now represents more than 50% of all unemployed.

The minimum wage in 1996 was set at 38 lats per month. At 50% of the average wage, it is quite high and suggests that the wage distribution is compressed at the lower levels. A proposal to increase the minimum wage to 50 lats is foreseen.

Public Finances

Latvia had to replace the Soviet government revenue system, which mainly consisted of levies on enterprise turnover, by a tax system suited for a market economy. It also had to build up a national tax administration. In its initial version, the new revenue system consisted of a personal income tax, a corporate profits tax, a payroll tax to finance social security expenditures, a turnover tax, and taxes on natural resources, land and property. In 1993, excise duties were added and the turnover tax was modified, and finally replaced by a value-added tax in May 1995. A new tax law has just been adopted. Tax avoidance is widespread, especially in the enterprise sector, and revenue collection is still a serious problem. The tax burden on those who do pay is already relatively high, so the only realistic option for increasing revenue is to improve administration and collection. Improvements in this area have been made recently.

The structure of government expenditure has changed considerably. Price subsidies were virtually eliminated, but the cost of general government administration and defence increased after independence. Expenditures are dominated by wages and transfer payments, mainly pensions. Together, these categories represent about two thirds of total expenditure. Interest expenditure and public investment remain low by international comparison. To ensure the sustainability of the pension system, the pension age has been increased, and a gradual transformation of the current pay-as-you-go system to a funded system has been initiated.

Public finances are highly decentralised and rather inflexible, specific tax sources are often earmarked for specific government sub-sectors. For example income tax accrues to local authorities while central government receives VAT revenue. Since the responsibility for macroeconomic policy rests with the central government, which to date has received the most volatile revenue sources, fiscal policy is severely handicapped. At the same time, pressure to reduce social expenditure is almost absent, since they are financed by constantly rising revenues from the payroll tax.

The new government which took office in December 1995 heralded a new period of fiscal discipline. In 1996 the budget deficit was 1.8% of GDP. The budget situation though is still fragile and there is only limited room for manoeuvre on both revenue and expenditure.

Enterprise Sector: Privatisation and Enterprise Restructuring

Until recently, large-scale privatisation, especially of the big industrial enterprises, had not advanced very fast in Latvia. Before 1994, there was no separate privatisation office, and the permission to privatise enterprises was only given on a case-by-case basis. However, the new government, formed in December 1995, took measures to accelerate the process. The piecemeal approach was abandoned and all assets were transferred to the Latvian Privatisation Agency (LPA), a semi-autonomous part of the Ministry of Economy, in February 1996. Foreigners will now also be able to participate fully in the privatisation process.

The preferred methods of privatisation will remain international tenders and public offerings, but citizens will be able to use vouchers distributed free of charge for part-payment. Virtually all remaining enterprises can now be privatised, including the large shipping company and the energy utilities. The objective is to complete privatisation by mid 1998. It is expected that the number of companies for which there are no buyers will increase towards the end of the privatisation process. The main reasons are the poor financial condition of some of the firms, the dragging out of the denationalisation and property restitution process and the lack of strategic investors. The good ratings recently awarded to Latvia by international credit rating agencies could help to increase foreign interest.

The privatisation of the energy utilities should end the influence of political considerations on the pricing and supply of energy, and thus hopefully reduce the important payment arrears in this sector. In February 1997, the World Bank made available loans to resolve the debt problems of the Latvian energy supplier. In April 1997, the LPA reached agreement with Russian Gazprom and a German consortium, which will take a stake of 32.5% in Latvian Gas. This constitutes a foreign direct investment of ECU 48 million.

The recent changes to the privatisation procedures, and the approval of recently submitted new legislation to eliminate almost all limitations on foreign land ownership, will probably increase foreign interest. The method of open, direct sales, combined with an important role for foreign investors, will promote faster enterprise restructuring: it should lead to relatively concentrated ownership and injections of new capital. The introduction of a new insolvency and bankruptcy regulation in September 1996 can also be expected to enhance restructuring, provided the new law

is implemented efficiently. However, bank lending is still a problem. Banks cannot easily provide long-term loans because of the lack of business plans, the absence of credit histories, difficulties in providing collateral due to the infancy of the land market, and the lack of a mortgage system. This will continue to hinder restructuring for some time.

Financial Sector

The authority responsible for monetary policy is the Bank of Latvia (BoL), which was created in July 1990. The commercial banking operations of the BoL were separated from its central bank functions in May 1992. The Bank has a large degree of independence, and is responsible for monetary and exchange rate policy, as well as banking regulation and supervision. The use of direct instruments of monetary policy - quantity limits on the amounts banks could lend and borrow - had ended by 1993. A standard range of indirect instruments are used but they are not yet fully effective, mainly because the money market is still very thin. Interest rates have been fully liberalised. The Bank extended credits to the government to cover the budget deficit during 1995.

As a consequence of the high commercial credit risk, due to a lack of proper collateral and the infancy of bankruptcy legislation, lending rates remain very high. As interest rates on deposits are considerably lower and bad loans inherited from the past still exist, the spread between deposit and lending rates is between 10 and 15 percentage points, which distinctly hampers the intermediation role of the banking sector to support domestic investment.

Interest rates are set to come down: since the beginning of 1996 the BoL reduced the refinancing rate from 24% to 4% (April, 1997) as inflation and Treasury bill rates have fallen. The fall in these rates should force banks to operate more efficiently and increase their lending activity in order to make profits. This in turn should help reduce interest rate spreads.

At the outset, in 1992, Latvia had three state-owned banks that accounted for about 90% of total assets and credits. Additionally, due to the liberal banking legislation, an important number of small banks were set up, some with foreign (mainly Russian) capital. The capital of the state-owned banks has been strengthened by the state, and they are now being prepared for privatisation. 75% of the banking sector is now in private hands of which 40% is accounted for by foreign ownership.

In 1994 and 1995, a large number of banks became insolvent. This escalated into a major banking crisis when the largest commercial bank collapsed in April 1995. The crisis began as a result of inexperienced bank management, excessive influence of large customers who were also bank shareholders, fraud in some banks, and too many new and undercapitalised banks. It escalated because of a lack of confidence in banks, and hesitant intervention by the supervisory authorities. To prevent a repeat of the crisis, new legislation has been approved to decrease the default risk in the banking sector. The new rules provide for limits on high-risk credits, increases in the required bank capital, prevention of excessive credit concentration, and a strengthening of the supervisory capacity of the BoL. As a consequence of the banking crisis, the lack of deposit insurance and the tighter supervision, the number of banks was reduced from 67 in 1992 to 33 by February 1997. Only 16 "core" banks are still allowed to accept household deposits. The profitability of the 16 core banks, which represent half of total assets, has improved considerably, but remains low. Most banks restrict business to "basic" services. Despite the progress since the crisis in 1995, the banking system as a whole remains fragile due mainly to weak portfolios, low profitability, and undercapitalisation.

A number of factors suggest that bank lending to the economy would increase. Such factors are the stabilisation of treasury bills rates and the lowering of market rates, improved liquidity of banks, availability of international credit lines to big banks and the increase in the activity on the interbank

market. At present, about two thirds of loans granted to the private sector have a maturity of less than one year.

Major steps have been taken to create an organised securities market, including the adoption of a legal framework for the securities market, the Riga stock exchange and the central depository. The stock exchange started operating in July 1995. Trading remained limited at first, but more recently started to pick up.

Economic and Social Development

Social Indicators

Latvia has a population of 2.5 million people. Population growth has turned negative due to emigration and a decline in the birth rate. In 1994, the size of the population decreased by 1.5%.

The education level is fairly good: 61% of the employed received higher secondary education and 8% are receiving training. Secondary education has concentrated on vocational and technical specialisations.

Regional and Sectoral Differences

Regional differences exist notably in terms of industrial concentration and unemployment. The lowest unemployment is found in the city of Riga, where 40% of the population lives and where unemployment is less than 4%. In other towns, where employment was often dependent on a single enterprise that was closed, unemployment is much higher. The rural parts of the country are sparsely populated and have a weakly developed infrastructure and production structure.

2.2 The Economy in the Perspective of Membership

Introduction

The European Council in Copenhagen in 1993 defined the conditions that the associated countries in central and eastern Europe need to satisfy for accession. The economic criteria are:

- the existence of a functioning market economy;
- the capacity to cope with competitive pressure and market forces within the Union.

These criteria are linked. Firstly, a functioning market economy will be better able to cope with competitive pressure. Secondly, in the context of membership of the Union, the functioning market is the internal market. Without integration into the internal market, EU membership would lose its economic meaning, both for Latvia and for its partners.

The adoption of the *acquis*, and in particular the internal market *acquis*, is therefore essential for a candidate country, which must commit itself permanently to the economic obligations of membership. This irreversible commitment is needed to provide the certainty that every part of the enlarged EU market will continue to operate by common rules.

The capacity to take on the *acquis* has several dimensions. On the one hand, Latvia needs to be capable of taking on the economic obligations of membership, in such a way that the single market functions smoothly and fairly. On the other hand, Latvia's capacity to benefit fully from the competitive pressures of the internal market requires that the underlying economic environment be favourable, and that the Latvian economy have flexibility and a sufficient level of human and

physical capital, especially infrastructure. In their absence, competitive pressures are likely to be considered too intense by some sections of society, and there will be a call for protective measures, which, if implemented, would undermine the single market.

The capacity and determination of a candidate country to adopt and implement the *acquis* will be crucial, since the costs and benefits of doing so may be unevenly spread across time, industries and social groups.

The existence of a broad based consensus about the nature of the changes to economic policy which membership of the Union requires, and a sustained record of implementation of economic reforms in the face of interest group pressure reduce the risk that a country will be unable to maintain its commitment to the economic obligations of membership.

At the level of the public authorities, Membership of the Union requires the administrative and legal capacity to transpose and implement the wide range of technical legislation needed to remove obstacles to freedom of movement within the Union and so ensure the working of the single market. These aspects are examined in later chapters. At the level of individual firms, the impact on their competitiveness of adopting the *acquis* depends on their capacity to adapt to the new economic environment.

The Existence of a Functioning Market Economy

The existence of a market economy requires equilibrium between supply and demand to be established by the free interplay of market forces. A market economy is functioning when the legal system, including the regulation of property rights, is in place and can be enforced. The performance of a market economy is facilitated and improved by the macroeconomic stability and a degree of consensus about the essentials of economic policy. A well-developed financial sector and an absence of significant barriers to market entry and exit help improve the efficiency with which an economy works.

Latvia has made substantial progress in establishing a functioning market economy. Prices and trade have been liberalised to a large extent and private property has become the dominant form of ownership. However, market entry for new firms is still made difficult by sometimes inconsistent legislation, red tape and arrangements which are not common practice in EU markets. The entry of foreign firms can meet with opposition from local firms. Although the majority of small and medium-sized enterprises have now been sold, the privatisation process started slowly and still has some way to go. The new government plans to have completed the privatisation of the larger state-owned enterprises by mid-1998.

The government has implemented legislation and set up some of the institutions of a market economy, but further efforts are needed. Competition and market regulation and supervision are limited. At the present time there is no effective regulatory body in place for monopolies but a competition council is to be established in the near future. The situation can be expected to improve with the adoption of the new law on competition, which has been passed recently by the Latvian Parliament. Further rapid development of market mechanisms will certainly be aided if the recent privatisation programme is successfully implemented; if foreign investment continues to upgrade and modernise technology; and if the plans for adopting and implementing legislation on industrial and competition policy are realised. The utilities and, in particular, energy supply will require particular attention.

The government has developed a number of strategies to increase competition. The key elements are to privatise industry, to encourage foreign investment and to give support to small and medium-sized enterprises. The observance of property rights is improving but is not complete. Recent decisions on ownership of land, in general and also by foreigners, should help in this area. Good progress in implementation of the Europe Agreement should help to ensure that the transition to membership of the Union is relatively smooth.

Significant progress has been made in stabilising the economy: inflation has been brought down, the economic decline caused by Soviet disintegration and the upheavals of transition was halted, and the economy withstood a banking crisis in 1995. The signs in 1996 were that the economy was back in a recovery, albeit a slow one. The stability of the macroeconomic environment is important to the development of the market. In turn, the sustainability of growth depends on how well the instruments of monetary and fiscal policy function and whether they are efficient.

At present, the main handicap for monetary policy is the vulnerability of the banking sector and the problem of bank lending. It has so far not been possible to use interest rates effectively as a policy instrument; hence the weight placed on the exchange rate instrument and reserve requirements as a way of controlling the money supply. One crucial objective is to gain credibility in policy-making. This requires constancy of decision making, co-ordination of policies and a healthy dose of realism. Despite the apparent absence of some of these elements during the banking crisis, the BoL managed to maintain the currency's stability without incurring huge costs from the loss of reserves.

The main handicap for fiscal policy is taxation: the tax base is limited, and tax collection is poor. In addition, flexibility in the central government budget is limited by the fact the revenue is very uncertain and variable - income tax accrues to local authorities while central government receives VAT revenue. The ability of the public administration to develop and implement policy needs to be strengthened.

An essential feature of a modern market economy is the financial sector, which in Latvia is clearly still vulnerable after the banking crisis in 1995. As a result of this crisis, the sector has strengthened somewhat and rules have been toughened. At present only a limited number of banks are allowed to take deposits because there is no deposit insurance scheme operating. These banks generally look sound, but they are not yet entirely fulfilling their role as financial intermediaries; this is partly because of the problem of bad loans on their books and the lack of collateral or competent risk assessments.

The Capacity to Cope with Competitive Pressure and Market Forces

It is difficult, some years ahead of prospective membership, and before Latvia has adopted and implemented the larger part of Community law, to form a definitive judgement of the country's ability to fulfil this criterion. Nevertheless, it is possible to identify a number of features of Latvia's development which provide some indication of its probable capacity to cope with competitive pressure and market forces within the Union.

This requires a stable macroeconomic framework within which individual economic agents can make decisions in a climate of a reasonable degree of predictability.

There must be a sufficient amount of human and physical capital including infrastructure to provide the background so that individual firms have the ability to adapt to face increased competitive pressures in the single market. Firms need to invest to improve their efficiency, so that they can both compete at home and take advantage of economies of scale which flow from access to the single

market. This capacity to adapt will be greater the more firms have access to investment finance, the better the quality of their workforce, and the more successful they are at innovation.

Moreover, an economy will be better able to take on the obligations of membership the higher the degree of economic integration it achieves with the Union ahead of accession. The more integrated a country already is with the Union, the less the further restructuring implied by membership. The level of economic integration is related to both the range and volume of goods traded with member states. Direct benefits from access to the single market may also be greater in sectors where there are a sizeable proportion of small firms, since these are relatively more affected by impediments to trade.

Latvia is a relatively open economy. With its exports, it competes primarily in the low value-added segment of the world market. Much of the competitiveness of the economy, and its ability to export, derives from the low level of wages. Exports may also still be benefiting from the devaluation of the currency in 1992. The opening up of the Latvian economy to competition has underlined the need for a further restructuring of industry and agriculture. Enterprise restructuring, especially in industry, is far from finished. Changes in the composition of external trade show that Latvia's light industry has not been able to upgrade its products to be able to penetrate western markets. The share of consumer goods in imports suggests that many local products are considered as being of inferior quality. So, the sector can produce at competitive prices mainly because of low labour costs, but its products do not generally match western quality and design standards. The announced acceleration of privatisation, with the possibilities for an important role for foreign investors, could remedy these problems and increase the pace of restructuring.

The degree of trade integration and the nature of trade with the Union suggests that Latvia, as it stands, would have difficulties in coping with competitive pressures within the single market. The Union accounts for about half of Latvian imports and somewhat less of its exports, but the imported and exported goods are not in the same categories: Latvia's main imports are energy, investment goods and consumer goods; its main exports are wood products. Latvian industry has not succeeded in exporting other goods to the West because of inadequate quality standards. Russia remains the single most important trade partner. One of Latvia's main sources of revenue is transit trade, because of its position between Russia and the Baltic Sea. At present, growth in the Latvian economy depends on the fortunes of wood production and textiles. An important area for future development, given the capacity and position of its three harbours, could be transport and communication services.

Further enterprise restructuring is crucial if Latvia is to be able to adjust to the requirements of membership of the Union, and also to meet the *acquis*. The number of firms has increased since independence as a result of enterprises being broken up and by the creation of new firms, but it is not clear whether the management techniques have changed. Firms do not have adequate access to new investment, as bank lending is weak. This is due to the lack of collateral, business records and risk management skills. Until recently foreign involvement was restricted, which has damped foreign investment, and therefore the import of technology, and business know-how. FDI flows typically constitute an efficient way to transfer technology to the enterprise affected as well as to the rest of the economy through demonstration and spillover effects. FDI would also be useful in helping Latvian industry adapt to the requirements of the *acquis*.

Investment has increased and the vast majority of this has gone to transport and communications. The banking sector has also received a significant amount of the investment. Research and development spending is low: total spending as a percentage of GDP amounted to 0.5% of GDP in 1995. However, this figure does not capture the full extent of R&D as much of it is embodied in capital and in the imported investment goods.

The banking sector has only recently begun to develop and remains weak in certain areas. It does not as yet provide sufficient lending to firms to boost restructuring, but there is a noticeable shift away from trading only Treasury paper towards more lending to firms operating in Latvia. The importance of bad loans decreases with the increase in business volume.

Prospects and Priorities

Significant progress has been made in stabilising the economy. Growth is picking up, inflation has slowed to 8.8% (April 1997), interest rates and the budget deficit have been reduced, the currency is stable and trade has been re-oriented to a large extent. The crisis in the banking sector set back economic development but the Bank of Latvia managed to maintain credibility and avoid a run on the currency. For these reasons, and because of the country's relatively low external indebtedness, the international credit rating agencies have awarded Latvia an investment grade rating.

However, the situation remains fragile. The trade deficit is high and rising, and the financial sector is still weak. Economic reform and the fiscal stance are maintained through the discipline of an IMF-supported programme. In addition, there is a certain lack of dynamism in the economy. The main problems are that the growth is dependent on low-value-added exports, and industrial production and productivity gains are still slow because of the lack of investment and restructuring to date.

The productivity of the agricultural sector will have to be increased to be able to cope with foreign competition, when the trade protection for the sector is reduced. Given that privatisation is almost complete and budgetary means are limited, a market-driven restructuring seems to be most appropriate.

Completing the institutional and legal framework of a market economy is an essential part of creating an environment in which private enterprises can flourish. Progress is being made in establishing the necessary legislation, but the effective implementation of new and existing legislation is perhaps even more important.

The economic policies of Latvia to date have not been guided by an elaborated medium-term plan. Short-term policies are within the framework of an IMF programme, which focuses on tightening fiscal policy, accelerating structural reforms, and further liberalising foreign trade.

Current policies are focused on rationalising public expenditure and reforming the revenue side, while strengthening the banking system and accelerating the privatisation process. The areas where significant progress has been made since the new government came to power are privatisation and the budget deficit. Policy initiatives to get the market mechanisms operating are just being devised and implemented: e.g., export promotion, and the development of small and medium-sized enterprises. The timing and impact of the initiatives is not entirely clear.

2.3 General Evaluation

Latvia has made considerable progress in the creation of a market economy. Trade and prices have largely been liberalized. Much headway has been made in stabilizing the economy. While there has been significant progress in establishing the legislative framework, effective implementation is still lagging behind. Also, not all the necessary regulatory bodies are in place or working properly. Privatization is not complete, the remaining state-owned companies are generally in poor financial condition, and there is a shortage of strategic investors.

Latvia would face serious difficulties to cope with competitive pressure and market forces within the Union in the medium term. The Latvian economy is relatively open and labour costs are low.

However, exports consists of mainly low value-added goods. Industrial restructuring, as well as enterprise restructuring, is still needed. The banking sector is underdeveloped and weak in parts. Agriculture needs to be modernized.

3. Ability to Assume the Obligations of Membership

The European Council in Copenhagen included among the criteria for accession “the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union”.

In applying for membership on the basis of the Treaty, Latvia has accepted without reserve the basic aims of the Union, including its policies and instruments. This chapter examines Latvia’s capacity to assume the obligations of membership - that is, the legal and institutional framework, known as the *acquis*, by means of which the Union puts into effect its objectives.

With the development of the Union, the *acquis* has become progressively more onerous, and presents a greater challenge for future accessions than was the case in the past. The ability of Latvia to implement the *acquis* will be central to its capacity to function successfully within the Union.

The following sections examine, for each main field of the Union’s activity, the current and prospective situation of Latvia. The starting-point of the description and analysis is a brief summary of the *acquis*, with a mention of the provisions of the Europe Agreement and the White Paper, where they are relevant. Finally, for each field of activity there is a brief assessment of Latvia’s ability to assume the obligations of membership on a medium-term horizon.

3.1 Internal Market Without Frontiers

Article 7a of the Treaty defines the Union’s internal market as an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured. This internal market, central to the integration process, is based on an open-market economy in which competition and economic and social cohesion must play a full part.

Effective implementation of the liberties enshrined in the Treaty requires not only compliance with such important principles as, for example, non-discrimination or mutual recognition of national regulations - as clarified by Court of Justice rulings - but also concomitant, effective application of a series of common specific provisions. These are designed, in particular, to provide safety, public health, environmental and consumer protection, public confidence in the services sector, appropriately qualified persons to practise certain specialist occupations and, where necessary, introduction or coordination of regulatory and monitoring mechanisms; all systematic checks and inspections necessary to ensure correct application of the rules are carried out on the market, not at frontier crossings.

It is important to incorporate Community legislation into national legislation effectively, but even more important to implement it properly in the field, via the appropriate administrative and judicial structures set up in the Member States and respected by companies. This is an essential precondition for creating the mutual trust indispensable for smooth operation of the internal market.

This chapter must be read in conjunction with, inter alia, the chapters on social policy, the environment, consumer protection and sectoral policies.

The Four Freedoms

A step-by-step approach is being taken to absorption of the *acquis* by the candidate countries:

- The Association Agreement between the Community, its Member States and Latvia was signed in 1995 and is being ratified. With regard to the four freedoms and approximation of legislation, the Agreement provides, in particular, for immediate or gradual application of a number of obligations, some of them reciprocal, covering, in particular, freedom of establishment, national treatment, free trade, intellectual property and public procurement.
- The Commission's 1995 White Paper (COM (95) 163 final), guidelines intended to help the candidate countries prepare for integration into the internal market, gives a closer definition of the legislation concerned. It identifies the "key measures" with a direct effect on the free movement of goods, services, capital and persons and outlines the conditions necessary in order to operate the legislation, including the legal and organizational structures. Twenty-three areas of Community activity are examined, dividing the measures into two stages, in order of priority, to provide a work programme for the pre-accession phase. The Technical Assistance and Information Exchange Office (TAIEX) was set up with the objective of providing complementary and focused technical assistance in the areas of legislation covered in the White Paper. A legislative database has recently been established by the Office.
- The candidate countries will have to implement all the *acquis*. The Action plan for the single market submitted to the Amsterdam European Council gives details of the priority measures necessary to make the single market work better between the Fifteen in preparation for introduction of the single currency. This will inevitably entail changes to the *acquis*.

- General Framework

Whatever their field of activity, undertakings must be able to operate on the basis of common rules. These are important since they shape the general framework within which economies operate and, hence, the general conditions of competition.

They include the rules on competition (on undertakings and State aid) and tax measures discussed elsewhere in this Opinion, the opening-up of public works, supply and service contracts, harmonisation of the rules on intellectual property (including the European patent), harmonisation of the rules on company law and accountancy, protection of personal data, transfer of proceedings and recognition of judgments (Article 220 EC Conventions).

Descriptive Summary

As regards public procurement, the Latvian law on government and municipal procurement, elaborated on the basis of the Uncitral (United Nations Commission on International Trade) Model Law, entered into force on 1 January 1997. Implementing rules were adopted in March 1997.

Moreover, Latvia intends to join the WTO Agreement on Government Procurement in the near future.

Latvia has been undertaking efforts to adopt legislation on intellectual and industrial property rights. It has acceded to a number of international conventions. Latvia is also preparing for accession to the World Trade Organisation (WTO)/TRIPS Agreement (Trade Related Aspects of International Property Rights) during 1997 and aims to accede to other international conventions (Rome

convention, Trademark Law Treaty, etc.) in the near future. New legislation concerning patents, trademarks, designs and copyright has been introduced in 1993.

As regards company law, Latvia's legal system recognises a number of different enterprises, including public and private limited companies. Over 52 000 companies are registered in the private sector. Only public limited companies can issue shares, and there is a basic level of shareholder protection. There are minimum capital requirements for public and private limited companies. There are a number of obligations to which companies are subject regarding the protection of creditors. Companies are required to publicise information about major decisions affecting them such as a reorganisation or liquidation, and there is a central register of companies to which the public has the right of access upon payment of a duty. At present the law governing companies is very fragmented. A new Commercial Code is being prepared which is intended to be in place by December 1997.

The *Law on Accounting* (1993) and the *Law on Company Annual Reports* (1993) provide the basic framework for the annual accounts of companies. The laws were amended in November 1996. Additional rules and regulations, as well as accounting standards exist. There is a *Law on Sworn Auditors* (1997). The Ministry of Finance and the Board of Accounting Methodology are responsible for the supervision of auditors.

Latvia has not yet passed a general law on the protection of personal data. Some data protection rules are laid down in several separate laws prohibiting institutions and officials from disclosing information. These concern the police, state statistics, revenue service, postal services, auditors, insurers, attorneys, telecommunication services, state control, doctors and credit institutions. This year an "umbrella" law on data protection for informatics will be passed, and in 1998 it is intended to harmonize legislation with the EC data protection directive.

Current and Prospective Assessment

Whilst the scope of the Public and Municipal Procurement Law covers most of the contracting authorities within the meaning of the classic sectors directives, the utilities sectors remain, for the time being, outside the scope of the rules.

At present, Latvian firms receive preferential treatment as regards the awarding of public procurement contracts. Firms located in the EU will get equal access only after the expiry of the transitional period laid down in the Europe Agreement (31 December 1999 at the latest).

Furthermore, the rules concerning services and tendering procedures are not in line with the EC requirements. Therefore, it appears that further amendments will be needed in order to comply with all the requirements of the directives. It seems that Latvian authorities intend to amend their law by the end of 1999. In any case, Latvia seems to be heading in the right direction. Accession to the WTO Agreement on Government Procurement would be an important step forward.

Regarding intellectual and industrial property rights, some progress has been achieved. The new Patent law, passed by Parliament in 1995, is considered by Latvian authorities to be consistent with the basic provisions of the Munich Convention. The law on trademarks includes the basic provisions of the corresponding Community legislation, but needs some minor amendments. The government plans to pass an amended Trademark Law in 1997.

Essential improvements in copyright protection are needed for computer programs, on rental rights and lending rights, satellite broadcasting and cable retransmission as well as duration of protection. A draft law is being prepared regarding the legal protection of topographies of semiconductor products. A new act on border enforcement has to be adopted. Effective implementation and

enforcement will remain a significant concern in the medium term due to the lack of experience of the authorities involved and to the current weakness of internal-control and border-enforcement mechanisms. However, important efforts are being undertaken to improve the situation. Piracy is still widespread.

According to the information on company law provided by Latvia, conformity with the First and Second Directives will be achieved by the end of 1997. There appears at present to be compliance with only parts of the Third, Eleventh and Twelfth Directives. Work is understood to be in progress to bring Latvia into line with the remainder.

The 1993 laws on accounting and the law on company annual reports made a good start towards alignment with the 4th Directive and were brought closer to full conformity by the 1996 amendments. A law on consolidated accounts, which should transpose the 7th Directive, is being prepared, with a deadline of 1 January 1998. The law on sworn auditors is based on the 8th Directive. Certain transitional problems are in evidence relating to the practical implementation of the new rules, including a shortage of qualified accountants and auditors, and major efforts will be required if these are to be solved in the medium term.

The existing fragmentary provisions on protection of personal data do not provide a level of protection compatible with the standards laid down in the EC framework Directive. Legislative changes are needed in particular to enable the creation of an independent authority to supervise the application of legislation.

Conclusion

In certain areas significant progress has recently been made regarding the adoption of framework directives necessary for regulating a market economy. Latvia has taken on or is in the process of taking on the most important directives.

Still, further legislative efforts must be made, especially regarding public procurement, intellectual and industrial property rights and data protection, before full compliance can be achieved. If the pace of harmonisation with EC-legislation achieved in the last year is maintained, Latvia should have a good chance of fulfilling the legislative requirements in this field in the medium term, although some problems of implementation and enforcement may persist.

Free Movement of Goods

Free movement of goods can be achieved only by removing measures which restrict trade – not only customs duties and quantitative restrictions but all measures with equivalent, i.e. protectionist, effect, irrespective of whether or not they are specifically aimed at domestic or imported products. Where technical standards are not harmonised, the free movement of goods must be ensured by applying the principle of mutual recognition of national rules and accepting the rule that national specifications should be no more stringent than is required to achieve their legitimate objectives. This rule was established in the *Cassis de Dijon* judgment.

For the purpose of harmonisation, the European Community has developed the “New Approach” which introduces an approach carefully balanced between government and private autonomous bodies and in which European Community legislation and European standards play a distinct complementary role. Thus, instead of imposing technical solutions, European Community legislation is limited to establishing the essential requirements which products must meet. Products manufactured in accordance with European standards are presumed to meet such essential requirements, but European standards are not the only way to prove such conformity. The “New Approach” works in conjunction with the “Global Approach” on product certification which governs the apposition of the “CE Mark” on the product. For other products such as pharmaceuticals, chemicals, motor vehicles, and food products, European Community directives follow the traditional regulatory pattern of providing fully detailed rules.

The free movement of goods also dictates that a number of Community harmonisation measures be transposed into national law. Implementation of health and safety harmonisation rules is particularly important and requires the establishment of appropriate mechanisms and organisations, both for businesses and the authorities.

Two of the “horizontal” directives essential to smooth running of the single market are the Directive on general product safety and the Directive on liability for defective products. The regulations concerning general product safety are covered in the section on consumer protection.

The rules on agricultural products (compliance with veterinary and plant-health standards) are explained in detail in the section on agriculture.

Descriptive Summary

Latvia has made considerable progress towards establishing the conditions for the free movement of goods. Latvia has already introduced liberal price, trade and foreign exchange regimes and established basic legal and commercial rules.

All prices have been liberalised except for energy (electricity, heating and gas) and water supply, housing rents, postal and telecommunication services, port services, railways, airport services, archives and stumpage fees in the forestry sector. Maximum and minimum prices are stipulated for different transit services for oil and oil products as well as for passenger transport by motor vehicles. For pharmaceuticals the profit margin may not exceed 20% per product.

In order to limit illegal circulation of excise taxable goods, protect consumers and to create a statistical data base the government maintains licensing requirements for tobacco, tobacco products and alcoholic beverages. The Ministry of Finance issues these licences according to the same objective criteria for both locally produced goods and to imported goods.

There are no quantitative limits on the number of licences to be issued. Following WTO requirements the quantitative sugar import restrictions were cancelled in March 1997 and instead automatic licences are granted by the Ministry of Agriculture. Also for grain and cereals, new laws eliminating quantitative import restrictions have been submitted to the Parliament and are due to be adopted during 1997. In general there are now no discriminatory measures.

With regard to technical barriers to trade, a law on the safety of products, services and liability of producers and service suppliers, corresponding to EC Directives 92/59/EEC and 85/374/EEC, was adopted in September 1996. This law covers not only products, but also services and damages to property and environment.

The last version of the legislative harmonisation programme presented in 1996 has announced transposition measures of New Approach directives to be adopted in a period going from 1997 to 1999. In the foodstuffs sector certain measures, basically horizontal, have been adopted.

Alignment for the chemical sector is planned for 1999. In the automotive sector, adoption of a type-approval system based on the EC system should become operational in 1999. In any case, it needs to be borne in mind that secondary legislation is often necessary for implementation of the general legislative framework.

A law on conformity assessment was adopted in 1996 as well as a number of regulations on the authorisation, accreditation and procedures of testing and calibration laboratories, certification and inspection bodies.

A new concept of standardisation was adopted in 1995 by the National Standardisation Programme providing for voluntary standards and organisation of the standardisation activities by the Latvian National Centre of Standardisation and Metrology. Latvia has affiliate membership of the European Committee for Standardisation (CEN).

Current and Prospective Assessment

The process of approximation of technical legislation to the EC *acquis* identified in the White Paper has made a slow start, but Latvia is currently making substantial efforts in order to adapt as quickly as possible to the *acquis* regarding the free movement of goods.

Important developments in this respect are the entry into force on 1 April 1997 of the new rules of origin allowing for Pan-European Cumulation and the numerous new laws aimed at harmonisation with EC-regulations on conformity assessments and standards. Nevertheless, further efforts are required for the full adoption and implementation of the *acquis*.

Efforts from Latvian authorities should now focus on improving the alignment record in technical legislation where reinforcement of technical expertise is needed. The adoption of the law on the safety of products, services and liability of producers and service suppliers was an important step forward. The New Approach Directive for electric equipment for use within certain voltage limits has already been implemented and the directives on electromagnetic compatibility and CE-marking are under implementation.

In the areas subject to national rules and not covered by Community harmonisation, there is too little information available to assess whether Community legal principles on the free movement of goods are properly applied in Latvia.

The reporting procedures which form part of the internal-market machinery are not yet operational and so cannot be used in the pre-accession period. The most important instruments in this connection are: Directive 83/189, requiring governments to report draft national technical standards and regulations; Decision 3052/95 on measures derogating from the principle of the free movement of goods; procedures by which complaints can be submitted to the Commission; and Article 177 of the Treaty, enabling Member States to ask for preliminary rulings from the Court of Justice. It is also hard to assess whether Latvia complies with the principle of mutual recognition; more information is required on its national rules, and on administrative practices, which can have an effect on product sales.

Conclusion

Some progress has recently been achieved, to fulfil the requirements of Community legislation on free movement of goods. Good efforts have been made in the fields of standardisation and conformity assessment. However, efforts from Latvian authorities should now focus on improving the alignment record in technical legislation where reinforcement of technical expertise is also needed.

If the pace of harmonisation adopted in the last year is maintained, implementing the *acquis* in this field should not represent a serious obstacle to Latvian accession. The major difficulty in this process is the lack of experienced staff.

The Latvian authorities should also ensure that, in areas not covered by Community harmonisation, their own national laws do not hamper trade. In particular, they should check that measures are proportionate to their objectives.

Free Movement of Capital

The Europe Agreement establishes the principle of the free movement of capital between Latvia and the EU from entry into force of the Agreement. This, as far as the obligations of Latvia are concerned, applies from the entry into force of the Europe Agreement as regards direct and portfolio investment, commercial credits and financial loans made by companies already established in Lithuania and, as regards branches and agencies of Community companies (as well as the self-employed), gradually during the transitional period.

The White Paper highlights the link between the free movement of capital and the free movement of financial services.

It suggests a series of measures to liberalise capital movements, ranging from medium and long-term capital movements and those linked to commercial operations, to short-term capital.

Descriptive Summary

There are no exchange restrictions in Latvia for payments on current account or for capital transfers to and from Latvia. The physical importation and exportation of financial assets is free. Consumption abroad of any financial services by Latvian residents is free. The Latvian currency is fully convertible with regard to current account transactions.

Foreign direct and portfolio investments in Latvia are regulated by the Law on Foreign Investment (last amended in April 1996), which guarantees foreign investors the same rights and obligations as the national laws. All notification requirements of foreign direct investments (FDI) were cancelled in the spring of 1996, as were restrictions on majority holdings by foreign investors in particular branches. Participation of foreign investors in the privatisation process was promoted through the abolition of restrictions on purchases of privatisation certificates by foreigners at the beginning of 1996 and by an acceleration of the privatisation process itself. The right of foreigners to buy land in connection with economic activity has been secured, provided that Latvia has reached an investment protection agreement with the foreign nationals' country of origin.

During the period from 1991 to 1995 substantial efforts have been made to attract FDI to develop the business and industrial base of Latvia. The total figure for the period 1990-1996 stands at 470 MECU

Since 1992, transport and communication have attracted the biggest proportion of FDI (42%), while financial intermediation and industry received 25% and 16% respectively.

In 1995 foreign exchange reserves of the Bank of Latvia decreased as a result of the banking crisis. In 1996 large capital inflows have brought the level of official international reserves above the pre-crisis level, reaching 518 MECU by September 1996. State involvement in international financial markets is restricted by limits imposed on external debt and total public debt amounts. According to the State Budget Law, maximum amounts are set for each year.

Current and Prospective Assessment

Almost all restrictions on capital movements have been abolished. Since January 1997, the purchase of land by foreign companies is less restricted. Legal entities in which a majority stake is held by foreign nationals from countries with which Latvia has mutual investment protection treaties are allowed to purchase land.

The scope of these liberalisation measures goes beyond the obligations of the Europe Agreement and represents a liberal approach to the movement of capital.

Following the amendments enabling foreigners to fully participate in the privatisation process, the securities market has experienced an upswing. This development is likely to continue taking into account the planned privatisation of a number of large companies. Also the macroeconomic stability which was recognised by the recent credit rating should contribute to increased investments.

Conclusion

Latvia has introduced current account convertibility and almost complete liberalisation of capital movements and should be able to abolish remaining restrictions in the medium term.

Free Movement of Services

The free movement of services functions through exercise of the right of establishment and the cross-border provision of services. Its foundations are the prohibition of discrimination, in particular on grounds of nationality, and rules on the alignment of divergent national legislation. These rules often concern both the right of establishment, which comes under the heading of the free movement of persons, and the freedom to provide services. Their implementation implies the establishment of administrative structures (banking control boards, audio-visual control authorities, regulatory bodies) and greater cooperation between Member States in the area of enforcement (mutual recognition arrangements).

A substantial amount of the legislation applicable to the free movement of services relates to financial services. It also concerns the problems relating to the opening-up of national markets in the sectors traditionally dominated by monopolies, e.g. telecommunications and, to a certain extent, energy and transport. These subjects will be dealt with in the sections of the Opinion specifically referring to them.

Descriptive Summary

The Banking sector in Latvia has largely recovered from the 1995 crisis. To avoid any repeat of this crisis, new prudential legislation has been introduced limiting high-risk credit, increasing required bank capital, preventing excessive credit concentration and strengthening the supervisory capacity of the Bank of Latvia.

In line with the policy of suspending licences of banks which do not comply with strengthened regulations, the licences of twelve banks were revoked in 1996. This has reduced the total number of banks in operation. 75 % of the banking sector is in private hands, of which 40% is accounted for by foreign ownership.

The presence of foreign banks is gradually increasing. Average interest rate spread in banking decreased to 10-15%. At present, the Bank of Latvia in collaboration with EC Phare is working on a new payment and settlement system's project to provide for real-time gross settlement in full conformity with EU requirements.

Deals on the Stock Exchange can be conducted by members only.

Investment services on a professional basis may be provided by investment firms, insurance undertakings and credit institutions duly licensed by their respective supervisory authorities. The Riga Stock Exchange is a non-profit joint stock company owned by commercial banks and financial institutions. The laws on securities and the law on the securities-market commission meet most but not all the requirements of the relevant EC regulations. The Securities-Market Commission was formed in 1996 in order to ensure the development and stability of the market. Its Council is appointed for a seven-year period by the Parliament, which ensures its independence. Tasks of this body include the protection of investors' interests and licensing of market participants.

The development of the privatisation process has led to a boost in the securities market, increasing market capitalisation.

Market concentration is very high in the insurance sector.

Two new draft laws on insurance supervision and insurance contracts are in the legislative process. EC rules on calculation of solvency of margin were adopted in 1993. A law based on the EC motor-vehicle insurance directive will enter into force in September 1997. An Insurance Supervisory Authority was set up in 1991 at the Ministry of Finance.

Foreign insurance companies in Latvia function widely under the same regulations as local insurers.

Current and Prospective Assessment

Latvia can be considered to be well advanced in harmonising its banking legislation to Community requirements. Of the White Paper Stage I measures, Latvia has implemented the First Banking Directive, Own Funds Directive and the Solvency Directive. Regarding the two other Stage I measures - a deposit guarantee scheme and a money-laundering law - drafts are currently in the legislative process. As a consequence of the current lack of resources in the financial sector, the minimum deposit guarantee amount foreseen by Community legislation cannot be met, but will be gradually increased in the coming years to reach the required level by the end of 1999. As for stage II measures, the Large Exposure Directive and the Second Banking directive have been fully implemented except for the single licence principle, whilst the Consolidated Supervision Directive, the Banks' Accounts Directive and the Capital Adequacy Directive are due to be implemented in 1997-1998.

Increases in the capital base and bank profitability are early signs of stabilisation in the banking sector. The intermediation role of the banking sector is, however, still hampered by high lending. Increased foreign direct investment and the introduction of legislation on collateral are assumed to help improve the situation.

Regarding legislation on Securities the Stage I directives have been partially introduced. The remaining requirements of Stage I and Stage II directives will be implemented by 1 January 1998. This will mean full implementation of the directives on insider dealing and on stock exchange listings. Investment companies and pension funds are regulated by the Law on Joint Stock companies. A law on investment is under preparation.

In the Insurance sector, direct branching by EU companies is not permitted, owing to a lack of supervision capacities. Also, guarantee fund requirements applicable to mutual associations are considered to be impossible to meet for the moment.

On 9 December 1996, the annual reports standard rules of insurance companies transposed into Latvian legislation the requirements of Directive 91/674/EEC on annual and consolidated accounts of insurance companies.

New laws on insurance and insurance contracts are being prepared to remove present deficiencies in the Latvian legislation and improve the degree of compatibility between Latvian and EU legislation.

Conclusion

Regarding the legislative aspects of financial services, Latvia is well advanced and will in the coming years not have any major problems in meeting the requirements of the main EC directives. The most important remaining difficulty is the strengthening of the banking sector in order for it to function as a financial intermediary supporting domestic investments.

If such strengthening does occur in the forthcoming years, there should be no major problem integrating the Latvian financial services system into the EU in the medium term.

– Free Movement of Persons

The free movement of persons encompasses two concepts with different logical implications in the Treaty. On the one hand, Article 7a in Part One of the Treaty on 'Principles' mentions the concept in connection with the establishment of the internal market and implies that persons are not to be subject to controls when crossing the internal frontiers between the Member States. On the other hand, Article 8a in Part Two of the Treaty on 'Citizenship of the Union' gives every citizen of the Union the individual right to move and reside freely within the territory of the Member States, subject to certain conditions. The abolition of frontier checks must apply to all persons, whatever their nationality, if Article 7a is not to be meaningless. While the rights deriving from Article 8a apply in all Member States, those stemming from Article 7a have not yet been fully applied throughout the Union.

(a) Free Movement of Union Citizens, Freedom of Establishment and Mutual Recognition of Diplomas and Qualifications

The Europe Agreement provides for the non-discriminatory treatment of workers that are legally employed (as well as their families). It covers the possibility of cumulating or transferring social security rights, and encourages Member States to conclude bilateral agreements with Latvia on access to labour markets. During the second phase of the transitional period, the Association Council will examine further ways of improving the movement of workers.

The White Paper considers the legislative requirements in order to achieve a harmonious development of the labour market, whilst simultaneously preventing distortions of competition.

The free movement of workers is one of the fundamental freedoms enshrined in the Treaty; freedom to practise certain professions (e.g. in the legal and health fields) may, however, be subject to certain conditions, such as qualifications. Depending on the case, these may be dealt with through coordination or by applying the principle of mutual recognition. Freedom of establishment is also guaranteed under the Treaty and covers the economic activity of self-employed natural persons and companies.

The free choice of place of residence may thus be subject to minimum conditions as to resources and health insurance where the person does not exercise a profession in the country concerned.

Descriptive Summary

Foreign nationals may have access to the Latvian labour market only after having obtained a work permit and a limited residence permit for a period specified in the employment agreement. A work permit can be obtained if the vacant employment position has been registered with the local branch of the State Employment Service for one month without having been filled and provided that no unemployed persons with relevant qualifications have been registered. This procedure does not apply to managers, directors of subdivisions, foreign experts or foreign contractual workers and specialists under certain conditions. In the case of a limited residence permit, this permit shall also be granted to the family members of the foreign national or stateless person.

Regarding mutual recognition of professional qualifications, the existing legislation concerning the education and training of dentists, doctors, veterinary surgeons, architects, midwives and nurses, fulfils the Community provisions only to a limited extent. Furthermore, enforcement structures have still mainly to be set up.

Current and Prospective Assessment

As a number of workers of different nationalities were brought into Latvia under the policy of the former Soviet Union, more than 600 000 persons are not citizens. Against this background, Latvia has decided at present to avoid a large influx of immigrants and to provide for a strict control over migration processes. As described above, exceptions are being made for foreign nationals representing key personnel. Such provisions will have to be adopted to similar provisions in the Europe Agreement, once it enters into force.

Regarding mutual recognition of professional qualifications, cooperation with experts from EU countries will be necessary to ensure conformity of the duration and structures of the relevant courses and a very sustained and intensive implementation of reforms will be needed if the *acquis* is to be taken up in the medium term. It must, however, be taken into account that the reforms of specific educational structures, by their nature, will take several years to implement.

Conclusion

A number of changes will have to be introduced in order to comply with the *acquis* on free movement of persons. As regards mutual recognition of professional qualifications, the preparation of the necessary legislative and enforcement measures will need to be very much intensified and sustained if they are to be in place in the mid-term perspective.

(b) Abolition of Checks on Persons at Internal Frontiers

The free movement of persons within the meaning of Article 7a of the EC Treaty, i.e. the abolition of checks on all persons, whatever their nationality, at the internal frontiers has not yet been fully

implemented in the Union. Doing away with checks on persons is conditional on the introduction of a large number of accompanying measures, some of which have yet to be approved and implemented by the Member States (see separate section on Justice and Home Affairs). However, that objective has been achieved by a limited number of Member States in accordance with the Schengen Convention (seven Member States already apply it and another six are working towards implementation).

The draft Treaty aims to make that objective easier to achieve within the Union by including a new chapter on creating an area of freedom, security and justice and incorporating the Schengen *acquis* into the EU.

Latvia has stated its desire and readiness to fulfil the provisions of the Schengen *acquis*. It has begun preparations to this end and has sought assistance in this connection from Member States, notably in regard to the strengthening of border controls.

General Evaluation

1. Latvia's progress in the implementation of legislation relating to the White Paper is summarised in annex. The table shows that at 30 June 1997, Latvia considered it had adopted national legislation giving effect to 253 of the 899 Directives and Regulations referred to in the White Paper. The figures, supplied by Latvia, refer to Community directives and regulations, referred to in the White Paper of 3 May 1995, in respect of which Latvia considers it has adopted national implementing regulations or has checked for compatibility. The table does not prejudge actual compatibility as such, on which the Commission is not able at this stage to state an opinion.

2. Latvia has made some efforts towards compliance with Internal Market legislation. It has in particular achieved a certain degree of alignment with Community rules in the areas of industrial property rights, conformity assessments and standards and, to a certain extent, in the area of Free Movement of Services. Legislation has been adopted in full or in part to implement most of the measures according to the Latvian authorities' assessment, though the Commission cannot at this stage express a position on its total compatibility with Community law. However, there are still gaps in important areas such as public procurement, intellectual property and personal data protection.

3. A severe problem for further progress may be the weakness of the Latvian public administration, which affects not only the pace of approximation of legislation but also the quality of its enforcement.

Similar doubts must be raised about the capacity of the various structures necessary to implement internal market legislation, but since the legislation is mostly so recent, and the structures themselves have in some cases not yet been set up, there is insufficient evidence at this stage on which to base a definitive judgement.

As things currently stand, the Commission cannot yet express an opinion on the capacity of companies, particularly small and medium-sized businesses, to implement the *acquis*.

4. Leaving aside certain specific aspects relating to agriculture, checks at the internal frontiers of the Union can only be abolished once sufficient legislative harmonisation has been achieved. This calls for mutual confidence, based in particular on sound administration (e.g. the importance of safety checks on some products at the place of departure). As far as goods are concerned, the completion of the internal market on 1 January 1993 was only achieved by doing away with all the formalities and checks performed by the Member States at the internal borders of the Union.

In particular these checks covered technical points (product safety), veterinary, animal-health and plant-health matters, economic and commercial matters (e.g. prevention of counterfeiting of goods), security (weapons, etc.) and environmental aspects (waste, etc.). In most cases, the abolition of checks was only made possible by the adoption and application of Community measures harmonising the rules on movement and placement on the market (particularly as regards product safety) and, where applicable, by shifting the place where controls and formalities are conducted within the Member States or their markets (in particular as regards VAT and excise duties, veterinary and plant-health checks, and the collection of statistics). A section of Latvia's present borders will become the Union's external frontier and this means border checks will need to be stepped up (see separate section on customs).

In view of the overall assessment that can be made of progress achieved to date and the rate at which work is advancing in the various areas concerned, it is difficult at present to put a time-scale on Latvia's ability to take over and implement all the instruments required to abolish internal border checks and to transfer those checks to the Union's external frontier.

5. Latvia has already adopted some elements of the *acquis* relating to the Single Market. Further progress will be needed with regard notably to public procurement, intellectual property and data protection. In most areas, enforcement needs to be strengthened. Strong efforts will be necessary with regard to the strengthening of the administration. In the medium term, provided considerable efforts are undertaken, Latvia should have adopted and implemented most of the Single Market legislation and made the necessary progress on the mechanisms of enforcement, in order to be able to participate fully in the Internal Market.

Competition

European Community competition policy derives from Art. 3 (g) of the Treaty providing that the Community shall have *a system ensuring that competition in the internal market is not distorted*. The main areas of application are anti-trust and state aid.

The Europe Agreement provides for a competition regime to be applied in trade relations between the Community and Latvia based on the criteria of Articles 85 and 86 of the EC Treaty (agreements between undertakings/abuses of dominant position) and in Article 92 (State aid) and for implementing rules in these fields to be adopted within three years of the entry into force of the Agreement. Furthermore, it provides that Latvia will make its legislation compatible with that of the Community in the field of competition.

The White Paper refers to the progressive application of the above provisions and those of the Merger Regulation (4064/89) and of Art. 37 and 90 (Monopolies and Special Rights).

Descriptive Summary

The current law on "***Competition and Restriction of Monopoly***" was passed in 1991, and amended in 1993. The law applies to all sectors of the economy and to both private and public enterprises, but only takes into account the Community *acquis* in the competition field to a limited degree. A new competition law has been recently adopted which represents an important step towards achieving the degree of approximation of legislation required.

The enforcement of competition legislation is controlled by the ***State Anti-Monopoly Committee*** which is supervised by the Ministry of Economics. This Committee will be replaced by the Competition Council in the new law.

The *State Aid Surveillance Commission* under the Ministry of Finance is responsible for the monitoring of state aid, which is about to establish a first aid inventory. It is therefore not yet possible to confirm that practically no state aid is granted in Latvia (as the Latvian authorities have stated).

Current and Prospective Assessment

The newly adopted law complies to a large extent with the *acquis*. But it will nevertheless need to be amended concerning some aspects of the rules on restrictive agreements, merger control, business secrets, procedural rules, as well as the rights and obligations of the Competition Council. The necessary amendments are currently being worked out.

In various sectors of the industry *exclusive rights, state monopolies or systems for the granting of licences* exist which need to be carefully analysed in order to see whether they need to be adjusted or abolished in order to comply with the Community *acquis*. This applies, in particular, to exclusive rights or systems for the granting of licenses in the telecommunication sector, the energy sector, in respect of export and import and trade in spirits and alcoholic drinks, the transport sector and the postal sector.

The substantial efforts made to establish a *state aid* inventory in accordance with Community requirements and the considerable progress made in drafting a Law on Public Aid and a Law for the functioning of the Monitoring Authority on state aid, giving it the powers necessary to implement state aid control, are welcomed.

Certain aid measures seem to be contingent upon export performance which is clearly not compatible with the Europe Agreement. Moreover, an important part of state aid seems to be granted through indirect forms of state aid, such as tax relief, debt write-off and tax arrears. These aid measures constitute operating aid which are only allowed under very strict conditions. Due to the lack of transparency it is as yet unclear whether the conditions for granting operating aid are complied with.

In addition to the adoption of legislation sufficiently approximate to that of the EU, *credible enforcement* of competition law requires the establishment of well functioning anti-trust and state aid monitoring authorities. It requires moreover that the judicial system, the public administration and the relevant economic operators have a sufficient understanding of competition law and policy.

Conclusion

Approximation of law in the field of *anti-trust* and *state aid* is progressing. The new competition law and, if adopted, the two draft laws on state aid will represent a significant step towards satisfying the requirements in this respect.

In the field of *state aid* the required transparency in the granting of *state aid* has not been achieved so far. A considerable effort will be necessary to fulfil the requirements in the field of state aid over the medium term. Close cooperation with the Community will be necessary.

It appears, moreover, that in certain *sectors exclusive or special rights* exist which are not compatible with the Community *acquis*. These problems should be addressed in the near future.

The skills of the staff of the monitoring authority on state aid seem appropriate but both competition authorities need further support to carry out their activities and to ensure a wide information of the concerned operators in the market place.

3.2 Innovation

Information Society

Present Situation

The economic and social effects made possible by the combination of information technology and telecommunications are great. In Latvia the potential for Information and Communication Technologies (ICTs) was neglected before 1990 although basic education generally was not. Now the awareness of their importance is high, and one result has been the recent creation within the Ministry of Transport of a Department for Informatics. Trade data for personal computers and the information technology sector as a whole are lacking but the existence of host computers on the Internet (about 1.6 per 1000 inhabitants at the end of 1996), as a relative measure of development towards the Information Society, suggests that Latvia is in line with the average for the region. Public support for computerisation should reach \$3.5m in 1997.

Conclusion

The Government is aware of the importance of the Information Society and is active within its own departments. The positive approach to modernising the telecommunication infrastructure ought to boost the rate at which the potentialities of Information and Communication Technologies (ICT) are taken up but it will start from a fairly low base.

Education, Training and Youth

Articles 126 and 127 of the EC Treaty provide that the Community shall contribute to the development of quality education and implement a vocational training policy aimed at promoting the European dimension in education and at enhancing industrial adaptation and the responsiveness of the labour market through vocational training policies.

The Europe Agreement provides for co-operation in raising the level of education and professional qualifications. The White Paper includes no measures in this field.

Descriptive Summary

The education budget was at some 5.2% of GDP in 1995, and the share of education in the overall budget amounted 25% in 1996 (up from 14% in 1993).

There are 1.100 schools, 460.000 pupils and 43.500 students in Latvia. Latvia has 17 state higher education institutions, 6 of which are universities and 13 private higher education institutions.

Latvia is currently undertaking reforms at all levels of the systems of education and training in order to further adapt the country to the needs of a democratic society based on a market economy. This is necessary, not only to achieve progress in regard to key economic factors (such as productivity and the quality of production, competitiveness on the international markets, development of the private sector, labour mobility, and unemployment), but also to ensure the democratic functions of society.

The 1991 education law gives the Ministry of Education authority for all levels of education and training.

Latvia is proceeding at a measured pace with privatisation, the transfer of responsibilities for education to local municipalities, and the development of Latvian educational and training priorities.

Some Latvian youth organisations have been participating in European youth activities since 1995 as a first step towards participation in the Youth for Europe programme.

The Tempus programme has contributed to the achievement of the goals of higher education reform and created the basis for cooperation with the EU higher education institutions.

Current and Prospective Assessment

In order to achieve a comprehensive upgrading of the education and training systems, considerable investments in curriculum-reform, teacher training, text books, equipment and buildings will be needed. Due to the financial constraints, this process is likely to take a number of years to achieve.

The participation of Latvia in the Community programmes will have positive effects on the people concerned and represent a good preparation for integration.

Conclusion

In the perspective of accession, no major problems should be expected in these fields.

Research and Technological Development

Research and Technological Development activities at Community level, as provided for by the Treaty and in the Framework Programme, aim at improving the competitiveness of European industry, the quality of life, as well as supporting sustainable development, environmental protection, and other common policies.

The Europe Agreement will provide for co-operation in these areas, notably through participation in the Framework Programme. The White Paper includes no direct measures in this field.

Descriptive Summary

Science and technology policies are formulated upon recommendations from the Ministry of Education and Science, the Ministry of Economy, and the Latvian Council of Science, which, since its establishment in 1990, has played an important role as a semi-governmental decision-making institution. It controls about 80 % of the science budget, 55 % of which is allocated by the grant system to particular projects. The Academy of Science has become an autonomous legal entity, functioning as a high-level honorary and advisory body.

RTD expenditure currently amounts to 0.45 % of GDP (cf. 1.6% in 1990).

Latvia currently has 25 research institutions supervised by the Ministry of Educational Science, and 17 state higher education institutions. Except for a few small research centres of private industry there are no private research institutions. The total number of personnel decreased from 30,000 in 1990 to 5,200 in 1994.

The Latvian national science and technology policy is oriented towards two general targets: to integrate the national research potential with higher education by implementing general and sectoral integration plans and agreements; and to reorient the Latvian research potential towards national priorities and to stimulate more active involvement of researchers in solving the actual economic, cultural and social problems. Among the subjects to be prioritised are information technologies, biotechnology and environmental protection.

Regular cooperation with the European Community started in 1992 with the 3rd Research and Technology Development Framework Programme. So far, cooperation has been concentrated mainly on COPERNICUS (Specific Programme for Cooperation with CECs and NIS) and remains low for participation in the 4th Framework Programme.

The statistics in this sector are not yet compatible with OECD standards.

Current and Prospective Assessment

The research system has undergone major changes, but at the same time, Latvian research has been seriously constrained due to lack of resources, related to the economic problems in general. However, Latvia has a number of strong research branches. Through their participation in the European Union research activities, Latvian scientists have demonstrated their ability to contribute internationally. Latvia has stated its interest in full association with the 5th Framework Programme.

Latvian science has already taken significant steps towards the integration of its research system with the Western European system, and the reform process continues. The reform initiatives aiming to modernise and rationalise the research system must be given continued support by the Latvian authorities.

Conclusion

In the perspective of accession, no major problems are expected in this field. Accession would be of mutual benefit.

Telecommunications

The objectives of EC telecommunications policy are the elimination of obstacles to the effective operation of the Single Market in telecommunications equipment, services and networks, the opening of foreign markets to EU companies and the achievement of universally available modern services for EU residents and businesses. These are achieved through harmonisation of the standards and conditions for service offerings the liberalisation of the markets for terminals, services and networks and the adoption of necessary regulatory instruments. The Directives and policies needed to achieve this have now been established, but the liberalisation of public voice telephony and operation of related infrastructure will be deferred for a year or two after 1998 in certain member states.

The Europe Agreement provides for co-operation aimed at enhancing standards and practices towards EC levels in telecommunication and postal policies, standardisation, regulatory approaches and the modernisation of infrastructure. The White Paper focuses on the approximation of regulation, networks and services, followed by further steps ensuring gradual sector liberalisation.

Descriptive Summary

Before regaining independence, Latvia's telecommunications network was managed as a part of the Soviet network, which meant that, for instance, all international connections were routed via Russia. The Latvian network was entirely automatic, but consisted largely of electro-mechanical equipment.

Since 1991, Latvia has moved swiftly to attract foreign investors through privatisation with strategic partners. The need for investments in infrastructure and installations will however remain very considerable in the foreseeable future.

Current and Prospective Assessment

Degree of Liberalisation

The government has partly privatised the state owned operating company, but liberalisation in the market for the provision of basic telephone services remains insufficient as long as the agreement on exclusive rights for Lattelekom continues. Other services such as mobile communications (4 operators), paging (4 operators) and data transmission have been liberalised at least partially but their impact is limited by the difficulty of obtaining commercially viable interconnection agreements with Lattelekom. Value added services are also liberalised but operators are obliged by law to use the Lattelekom infrastructure. Nevertheless, there are some 30 Internet service providers on the market. Private operators can offer CATV.

Approximation to EC law

Latvia has opted for a gradual restructuring of its telecommunications sector. The current law (1993 Law on Telecommunications) allows for the liberalisation of some added value services and also for the privatisation of Lattelekom, which became a limited company since 1994 which is 51% State owned and 49% under foreign ownership (TILTS consortium with the participation of Western European Operators). It also gave exclusive rights for voice telephony and data transmission services to Lattelekom for operation of the public network until 2013.

The TILTS consortium had to sign an agreement with the Government which committed to full digitisation within eight years, universal service and a stipulated tariff system. It now seems that these conditions will not be met and the agreement is currently being renegotiated. At the same time the agreement on exclusive rights for Lattelekom is also being renegotiated. The new Government has indicated its intention to fully liberalise telecommunications by 2003.

- The responsibility for setting tariffs for Lattelekom is with the Telecommunications Tariff Council under the supervision of the Ministry of Transport. Services partially liberalised are mobile communications, paging and data transmission by satellite. However, their impact is limited by the difficulty of obtaining commercially viable interconnection agreements with Lattelekom. Based on progress to date there is serious doubt that Latvia has the administrative capacity to achieve its target of **liberalising telecommunications by 2003**.

Infrastructure Before regaining independence, Latvia's telecommunications network, consisting largely of obsolete equipment, was managed as a part of the network of the USSR. Lattelekom had expanded the telephone penetration rate to 29.7 per 100 inhabitants by the end of 1996 but the average growth over the past 5 years has been very slow. An ambitious modernisation programme has resulted in 14% of lines digitised in 1995 and the commitment made by TILTS of contributing

to 100% digitisation of the network within 8 years may no longer be feasible, as the revenue of Lattelekom is too low to finance investments. At current PPP per capita, revenue per telephone line (about 128 ecu in 1995) cannot be increased enough to finance additional investment. Tariff reform has been delayed by the state consumer protection body in the interests of maintaining affordability of local service.

Two GSM networks are in operation and a third GSM operator will be soon granted a licence. The penetration for mobile telephones is 0.7/100 inhabitants which is third among the applicant countries. ISDN services are not yet offered to business customers.

The main State telecommunications equipment company (VEF) faces difficulties because of the obsolescence of its technologies and production techniques.

Competitiveness of the Sector

There is a large number of unsatisfied requests for telephone service --new subscribers have to wait on average 6.0 years for their lines- and at today's rate of network expansion, it will be twenty years more before even basic telephone service will be universally available at the present EC levels.

The productivity of the public network operator as judged by the number of employees/1000 lines (9.3) is low compared to the average in the EU (4.9) but high relative to other applicant countries (12.1). Significant investments would be necessary to bring about the modernisation required by the economic integration.

Conclusion

Latvia will have some difficulty in meeting the *acquis communautaire* in the medium term because legislative reform is progressing slowly and existing commitments concerning exclusive rights for the public operator are a barrier to liberalisation. Greater competitiveness for the public operator must be achieved to attract the investment needed to modernise and face up to competition.

Audio-visual

The audio-visual *acquis* aims, in the context of the Internal Market, for the provision and free movement of audio-visual services within the EU as well as the promotion of the European programme industry. The Television Without Frontiers Directive, which is applicable to all broadcasters regardless of the modes of transmission (terrestrial, satellite, cable) or their private or public nature, contains this *acquis*, setting down basic rules concerning transfrontier broadcasting. The main points are: to ensure the free movement of television broadcasts throughout member states; to promote the production and distribution of European audio-visual works (by laying down a minimum proportion of broadcasting time for European works and those by independent producers); to set basic standards in the field of television advertising; to provide for the protection of minors and to allow for the right of reply.

The Europe Agreement provides for co-operation in the promotion and modernisation of the audio-visual industry, and the harmonisation of regulatory aspects of audio-visual policy.

The Television Without Frontiers Directives is a Stage I measure in the White Paper.

Descriptive Summary

Only limited information is available concerning the situation in this field in Latvia.

The legal framework for the audio-visual sector is determined by the 1995 Radio and Television Law, the Law on the Press and Other Media, and the Acts of the National Board of Radio and Television.

Current and Prospective Assessment

The audio-visual sector in Latvia is attempting to re-establish itself after major upheavals in recent years, and is characterised by rapid growth and constant change. Its ability properly to adhere to the *acquis* presupposes an upgrading of the capacity of the programme-making industry to meet the important challenges of an adapted regulatory framework.

Although full information on Latvian audio-visual legislation is lacking, the analysis to date reveals a number of deficiencies, including questions of freedom of reception, jurisdiction, promotion of European works, and advertising rules.

A revision of the current legislation in this sector is due to begin in 1997. The Latvian Government has stated that this will address all the current deficiencies.

Conclusion

Provided that the necessary legislative amendments are pursued with sufficient urgency and that they are accompanied by the necessary structural adaptation of the industry, Latvia should be able to meet EU requirements in the audio-visual sector in the medium term.

3.3 Economic and Fiscal Affairs

Economic and Monetary Union

By the time of Latvia's accession, the third stage of EMU will have commenced. This will mark important changes for all Member states, including those that do not participate in the euro area. All Member states, including the new ones, will participate fully in the economic and monetary union. Their economic policies will be a matter of common concern and they will be involved in the coordination of economic policies (national convergence programmes, broad economic guidelines, multilateral surveillance, excessive deficit procedure). They will be required to respect the stability and growth pact, to renounce any direct central bank financing of the public sector deficit and privileged access of public authorities to financial institutions, and to have completed the liberalisation of capital movements.

Accession means closer monetary and exchange rate co-operation with the European Union. This will require strengthening structural reforms in the area of monetary and exchange rate policies. Member states not participating in the euro area will be able to conduct an autonomous monetary policy and participate in the European System of Central Banks (ESCB) on a restricted basis. Their central banks have to be independent and have price stability as their primary objective. Monetary policy has to be conducted with market-based instruments and has to be "efficient" in transmitting its impulses to the real economy. Therefore, reforms need to be pursued to tackle factors that hinder the efficiency of monetary policy, such as the lack of competition in the banking sector, the lack of development of financial markets and the problem of "bad loans" in the banking sector. Finally all

Member states shall treat their exchange rate policy as a matter of common interest and be in a position to stabilise their exchange rates in a mechanism yet to be decided.

As membership of the European Union implies acceptance of the goal of EMU, the convergence criteria will have to be fulfilled by Latvia, although not necessarily on accession. While the fulfilment of the convergence criteria is not a precondition for EU membership, they remain key points of reference for stability oriented macroeconomic policies, and must in time be fulfilled by new member states on a permanent basis. Hence the successful conclusion of systematic transformation and market oriented structural reforms is essential. Latvia's economic situation and progress has already been analysed in preceding chapters of this Opinion.

Current and Prospective Assessment

The independence of the Bank of Latvia from the government is largely guaranteed by the Law on the Central Bank. Price stability is the stated objective of the central bank. The provisions of the Law concerning state budget financing are not in line with the Treaty requirements. This is because the provisions of the Law on the Central Bank concerning the limits of the Central Bank budget deficit financing are amended every year by an agreement between the Central Bank and the Ministry of Finance. In 1995, due to a sharp budget crisis, the yearly amendments to the Law were not respected.

Monetary policy in Latvia has been effective in reducing inflation but it is still hindered by the relative youth and lack of depth of financial markets. A growing Treasury Bill market (with rates falling and maturities lengthening) provides additional support for the higher local currency rating and underpins the ongoing development of still narrow capital markets. The Latvian banking sector is gradually recovering from the 1995 crisis, and it is characterised by a high degree of privatisation. In May 1996, 75% of the total share capital was in private hands, of which 40% is accounted for by foreign ownership. The bankruptcy law for banks was approved in 1996 but it is still difficult to enforce. A standard range of indirect instruments are used by the Central Bank but they are not yet fully effective mainly because the money market is still very thin.

Since February 1994, the Latvian exchange rate regime is a peg to the IMF Special Drawing Rights (SDR). It has been used as the linchpin of the monetary policy strategy in the fight against inflation. During the 1995 banking crisis, the Central Bank succeeded in keeping the exchange rate stable by tightening monetary policy. Since then a sound fiscal stance and stricter central bank supervision on the financial sector have helped to keep the exchange rate stable.

Conclusion

It is premature to judge whether Latvia will be in a position, by the time of its accession, to participate in the euro area; that will depend on the success of its structural transformation permitting to attain and to adhere permanently to the convergence criteria, which are not however a condition of accession.

Latvia's participation in the third stage of EMU as a non-participant in the euro area poses problems in the medium term. The provisions and the practice of the central bank's budget deficit financing are not yet fully compatible with EC rules. While the record of exchange rate stability and inflation reduction is encouraging, sustained efforts need to be continued to strengthen the banking sector which is still vulnerable.

Taxation

The *acquis* in the area of direct taxation mainly concerns some aspects of corporation taxes and capital duty. The four freedoms of the EC Treaty have a wider impact on national tax systems.

The indirect taxation *acquis* consists primarily of harmonised legislation in the field of Value Added Tax and excise duties. This includes the application of a non-cumulative general tax on consumption (VAT) which is levied on all stages of production and distribution of goods and services. This implies an equal tax treatment of domestic and non-domestic (import) transactions. The VAT *acquis* also contains transitional arrangements for the taxation of transactions within the European Union between taxable persons. In the field of excise duties the *acquis* contains harmonised tax structures and minimum rates of duty together with common rules on the holding and movement of harmonised excisable goods (including the use of fiscal warehouses). As a result of the introduction of the Single Market, all fiscal controls at the Community's internal frontiers were abolished in January 1993.

The mutual assistance between member state tax authorities is an important feature of administrative cooperation in the Internal Market; the respective Directive covers both direct and indirect taxation.

The Europe Agreement contains provisions on approximation of legislation in the area of indirect taxation.

The White Paper contains as Stage I measures those which make up the main requirements of the indirect taxation *acquis* (essentially, those measures applied in the Community up to 1993), and as Stage II measures those which are in addition necessary to implement the full indirect taxation *acquis*.

Descriptive Summary

Direct Taxation

The two company taxation Directives and the Arbitration Convention provide for a mechanism which applies on the basis of reciprocity. Respective provisions can therefore by definition not be expected to exist before accession.

Indirect Taxation

The overall contribution of VAT and excise duty revenue to the Latvian state budget was about 39% and 14% respectively in 1995. This is expected to continue on an upward trend.

Value Added Tax

The current Latvian VAT system was introduced in May 1995 replacing the previous Turnover Tax. Latvia applies a single VAT rate of 18% which is applicable to all taxable transactions, including imports.

Certain activities are exempt from VAT without the right to claim the input credit on such supplies. These exemptions relate mainly to activities in the public interest, financial and insurance services, property and lotteries and similar games. Taxable persons are entitled to deduct VAT incurred on their purchases for business purposes of goods and services. However, the Latvian VAT Act does not contain any provisions enabling tax to be refunded to taxable persons not established within the country.

Excise

The current system of excise duty in Latvia was introduced at the same time as the VAT system. Excise duties are levied on a wide range of products including products other than those subject to common excise duties within the Community (mineral oils, alcohol and alcoholic beverages and manufactured tobacco). For each product category, the duty is specific in nature; nevertheless for a few products including certain categories of tobacco, the duty is ad valorem. Tax stamps and special labels are used for tobacco products and alcoholic beverages.

Mutual Assistance

The tax administration has not yet had to develop its capacity for mutual assistance with the tax authorities of Member States, since mutual assistance is a feature which would only become applicable on accession.

Current and Prospective Assessment

Value Added Tax

The current VAT system in Latvia has been based on the main principles of the VAT legislation of the Community. However, it is characterised by being very general and inconsistent in its application.

The Latvian approach regarding exempt transactions deviates to a large extent from that of the Community legislation both in terms of scope and substance; legislative amendments are planned. Since Latvia does not operate any arrangements for the refund of VAT to non-registered foreign taxable persons, VAT represents an increased cost to such traders.

Latvia's membership of the European Union would require substantial adjustment to bring the VAT legislation into line with the requirements of the Community *acquis*, both in respect to the general provisions of the Community VAT legislation and as regards the system of taxation necessary in a Community with no internal frontier controls.

The Latvian national strategy plan for implementing the recommendations of the White Paper regarding VAT provides for some changes to the VAT Act.

Excise

There are significant discrepancies between the Latvian excise regime and EU requirements.

Firstly, there exists no excise suspension system where goods can move between authorised tax warehouses without payment of duty. In addition, the registration of traders for excise purposes needs to be reviewed.

Secondly, taxation of certain tobacco products on an ad valorem basis is not compatible with Community law. Similarly the specific duty on cigarettes as well as the tax treatment of beer are not in conformity with the requirements of Community excise legislation.

In the event of accession, excise duties on products not belonging to the above-mentioned categories could continue to apply provided, however, that they would not give rise to border-crossing formalities in trade between member states and that they complied with the principles of non-discrimination between national products and products originating in other member states.

In order to ensure a correct application of Community excise legislation it is essential that Latvia sets up a warehousing system based on the Community model as soon as possible, strengthens control procedures and adapts the structure and level of its excise rates in such a way that they comply with Community requirements.

The Latvian national strategy plan for implementing the provisions of the White Paper envisages adjustment of Latvian excise legislation in line with White Paper Stage I measures by 1 January 1998. The main objectives are the gradual approximation of excise rates on motor fuels towards the EU minimum rates, and the design of a new excise tax system applicable to five groups of goods, three of which are oil products, alcoholic beverages and tobacco products. As short term objectives, it is intended to create a single licensing authority for excise traders and to strengthen control procedures for using tax stamps. However no full harmonisation of legislation is planned.

Mutual Assistance

There would also be a need, on accession, to implement the appropriate arrangements for administrative cooperation and mutual assistance between Member States. These requirements are essential for the functioning of the Internal Market.

Conclusion

The *acquis* in respect of direct taxation should present no significant difficulties.

As regards indirect taxation, although some progress is being made, a considerable effort will be required if Latvia is to comply with the *acquis* concerning VAT and excise duties in the medium term.

It should be possible to start participating in mutual assistance as the tax administration develops its expertise in this respect.

Statistics

The main principles of the Community *acquis* relate to the impartiality, reliability, transparency, confidentiality (of individual information) and dissemination of official statistics. In addition there exists an important body of principles and practices concerning the use of European and international classifications, systems of national accounts, business registers, and various categories of statistics.

The Europe Agreement provides for co-operation to develop effective and reliable statistics, in harmony with international standards and classifications.

The White Paper includes no provisions in this field.

Descriptive Summary

The Central Statistical Bureau (CSB) is the central body charged with producing and disseminating official statistics in Latvia.

The legal basis for Latvian official statistics consists of the 1993 Act on State Statistics.

Current and Prospective Assessment

Amendments which have been introduced into the 1993 Act represent progress towards compatibility with EU standards. Important progress is still required.

There are deficiencies in Latvian statistics in sectors such as the business register, business statistics, national and agricultural accounts, and the application of classifications and nomenclature.

Conclusion

Latvia will require a sustained effort if it is to comply with EU requirements for official statistics in the medium term.

3.4 Sectoral Policies

Industry

EC industrial policy seeks to enhance competitiveness, thus achieving rising living standards and high rates of employment. It aims at speeding up adjustment to structural change, encouraging an environment favourable to initiative, to the development of undertakings throughout the Community, and to industrial co-operation, and fostering better exploitation of the industrial potential of policies of innovation, research and technological development. EU industrial policy is horizontal by nature. Sectoral communications aim at transposing horizontal concepts into specific sectors. EU industrial policy results from an articulation of instruments from a number of Community policies; it includes both instruments related to the operation of markets (product specification and market access, trade policy, state aids and competition policy) and measures related to industry's capacity to adapt to change (stable macro-economic environment, technology, training etc.).

In order to cope with competitive pressure and market forces within the Union, the industry of applicant countries needs to have achieved a certain level of competitiveness by the time of accession. The applicant countries need to be seen as pursuing policies aimed at open and competitive markets along the lines set out in Article 130 ("Industry") of the Treaty. Co-operation between the EC and the applicant countries in the fields of industrial co-operation, investment, industrial standardisation and conformity assessment as provided for in the Europe Agreement is also an important indicator of development in the right direction.

Descriptive Summary

Latvia's industrial output stood at around ECU 1.1 billion in 1995, equivalent to about one third of the industrial production of Luxembourg. Industry production accounts for 20% of total employment. The total number of enterprises in industry is estimated at around 44,000, 90% of which are small firms.

At the beginning of transition industry was the biggest employer in the economy. The transition process entailed a marked decline in industrial production. The share of industry in GDP stood at 33% in 1995, down from 46% in 1990 (the share of the service sector has instead increased from 30% to 50%). The decrease reached -60% between 1991 and 1993, slowed down between 1993 and 1995 and worsened in 1995 due to the banking crisis of May 1995. As of today this negative trend has not yet fully reversed.

Latvia is characterised by a small-sized and diversified industry. Its industrial tradition dates back to the 19th century, when the region was the Russian empire's main centre for mechanical engineering, wood craft and flax industries. During the period of independence (1918-1940), industry diversified and focused on the manufacturing of consumer goods for the local market (tableware, cameras, radios, bicycles, cars). During the Soviet era emphasis was put on the development of heavy industries based on imported raw materials (steel and transport equipment), while the output of light industry was maintained (telephones, radios, washing machines). After independence and the consequent loss of Latvia's main outlets in Eastern European countries, the industrial crisis mostly affected those traditional sectors in need of restructuring.

As a result, the industrial structure is changing to become more similar to that of its Baltic neighbours. Industrial growth now tends to concentrate on low value added, labour intensive sectors, i.e., food processing industry, construction, forestry, and clothing, which have been successful in progressive integration into the EU market, while developing competitive advantages in trade with the Russian Federation and other CIS countries.

Latvian industry: main production sectors in Jan-Sept. 1996

Secto	%-share industrial production (value added)
Food processing	44
Textiles / Clothing	11
Wood processing	8
Chemicals	8
Transport vehicles	6
Machinery & equipment	4
Non-metallic mineral products	3
Printing & publishing	2
Metal products	2
Electrical machinery & apparatus	2
Furniture	2
Electronic engineering	1
Total of the above	93
Other sectors	7
Total Industry	100
<i>Industrial production as % GDP</i>	<i>17</i>

Food processing is the leading sector in Latvia in terms of both value added and employment. Production has reoriented to meet the requirements of the local market, which is reflected by a consequent decrease in imports. Growth is mainly directed to dairy and fish products. Almost 90% of exports in this sector go to the CIS.

Wood processing is the spearhead of Latvian industry. It is the only sector which records a rise in employment. Wood is one of the country's major national assets (it covers 40% of the territory). Wood products account for one fourth of Latvian exports (of which 85% go to western markets and mainly to the EU). The share of processed products (sawn materials as opposed to round wood) in exports is increasing. Manufacturers are trying to develop this trend, by implementing marketing principles (identification of niche markets, collaboration with western designers to boost exports of furniture, etc.).

Textiles/clothing is another dynamic sector, which has successfully restructured. New companies have been created in the clothing sector. The sector records the fastest increase in exports (50% of the exports are directed to the EU and 30% to the CIS).

Construction materials industry is growing fast, which is mainly achieved through the repairs of the road network and exports of cement to western countries.

Chemicals industry maintains its production levels thanks to outlets in neighbouring Baltic and CIS countries.

The production of **machinery and electrical devices** is slightly narrowing, though exports to EU and Latvia are growing.

Steel and engineering industry (such as the manufacturing of mini buses, passenger rail cars, radios and telephone equipment) inherited from the Soviet Union have failed to restructure and continue their decline.

Acceleration of the process was achieved in 1996 through a centralisation to the Latvian Privatisation Agency (LPA), to which 90% of assets were transferred. LPA has privatised 66% of them so far. Small-scale privatisation is almost completed, often with significant foreign participation. In order to encourage more foreign participation in the privatisation process, the restrictions on purchase of land by foreigners were liberalised in January 1997. The Government objective is to finalise privatisation/liquidation of state assets by mid-1998. In 1996 the share of the non-state sector in industrial output accounted for 42%.

Current and Prospective Assessment

Latvia experiences the most dramatic change in industrial structure among applicant countries. It is also the only applicant country in which industry is up to now still in decline. It cannot be excluded that the economic transition will lead to a certain de-industrialisation of the country, coupled with a relatively strong service sector, which reflects Latvia's geographic position as a transit country, as well as a specialisation in financial services.

FDI has been relatively large considering the size of the economy: about 20 % of total investment has been financed that way - even more in 1996 -, but it appears that only 1/5 of FDI goes to industry. Strong financial policies have underpinned stabilisation for some time, so that the domestic banking system is now, after a shake-out in 1995, starting to provide medium to long term financing for industry.

Given this favourable environment, it is surprising that investment is still not picking up. Once it does, as we expect, the growth prospects appear to be good. But growth is likely to be uneven. One could expect that Latvian industry will grow mainly in domestically orientated sectors (including agri-food) and a few highly focused medium-sized firms that use local resources (including wood from Belarus and flax from Lithuania) and sell their niche products on the world market.

Conclusion on industrial competitiveness

Latvia has managed to restructure its inherited industrial base to a considerable extent. The most urgent need for the future is the strengthening of measures to foster domestic capital formation and FDI. Nevertheless, not all industrial sectors are assured of their competitiveness. Provided that current positive trends continue regarding privatisation, enterprise restructuring, and the ability to attract further FDI, the Latvian economy should be able to cope with European integration in the mid-term.

An evaluation of the acquis specific to the free circulation of industrial goods is to be found in the separate section on the internal market.

Agriculture

The Common Agricultural Policy aims to maintain and develop a modern agricultural system ensuring a fair standard of living for the agricultural community and the supply of food at a reasonable price for consumers, and ensuring the free movement of goods within the EC. Special attention is given to the environment and rural development. Common market organisations exist to administer the CAP. These are complemented by regulations on veterinary health, plant health and animal nutrition and by regulations concerning food hygiene. Legislation also exists in the area of structural policy, originally developed primarily to modernise and enlarge agriculture, but more recently with an increasing emphasis on the environment, and the regional differentiation of the policy. Since reforms in 1992, increasing contributions to farm support have come from direct aid payments compensating cuts in support prices.

The Europe Agreement provides the basis for agricultural trade between Latvia and the Community and aims to promote cooperation on the modernisation, restructuring and privatisation of Latvia's agriculture sector as well as the agro-industrial sector and phyto-sanitary standards. The White Paper covers the fields of veterinary, plant health and animal nutrition controls, as well as marketing requirements for individual commodities. The purpose of such legislation is to protect consumers, public health and the health of animals and plants.

Descriptive Summary

Agricultural Situation

The value of the agricultural production in 1995 was approximately 0.11% of that of the Union.

In the years after independence production contracted and the share of agriculture of GDP fell. In 1995 agriculture and forestry contributed 9.9% of the GDP and over 18% of the employment. Total agricultural area in Latvia is 2.54 million ha of which 1.7 million ha are arable land (39%). 413,400 ha is used for fodder crops, 408,000 ha for cereals and 75 100 ha for potatoes. 44% of Latvia is covered by forests (2.9 million ha) and timber production is rising steadily. Timber occupies 26% of Latvia's total export volume.

Since independence Latvia has pursued a privatisation strategy. At present large family farms occupy 47% of the agricultural land (average size: 20 ha), while 32% is occupied by very small farms or by household plots (average size: 2-4 ha) and 17% by 656 "statutory companies". As a result of the land reform the state land reserve holds 542,000 ha of unclaimed land. On 1 June 1996 46 500 titles were registered at the land registry, representing 678 100 ha.

In 1995 Latvia produced 690 000t cereals (58% self sufficiency), 864 000t potatoes (167%), 250 000t sugar (43%), 330 000t vegetables and fruits, 937 000t milk (100%), 62 000t beef meat (66%) and 56 000t pig-meat (66%).

The share of agricultural trade (including fish) was 9.7% for imports and 15.9% for exports. Latvia is a net importer of agricultural products. The trade balance with the EU has deteriorated, in particular because of increasing imports from the EU. However, the trade balance with the New Independent States remains positive. Main exports are fish (10%), beverages (10%) and dairy products (9.7%). Dominant imports are sugar (12.5%), beverages (12.3%) and cereals (11%).

The processing industry, except grain, has been privatised, but generally operates at 15-30% of its capacity.

Agricultural Policy

The PSE (Producer Subsidy Equivalent) calculated by the OECD was 8% in 1995, compared to 49% for the EU.

Latvia aims to support family farming and to establish new agricultural markets. Price support policies are in first line limited to border protection after artificially set prices paid by the state owned downstream industry had to be abolished due to privatisation.

Subsidies have been used since 1994 and are linked to the sectoral policies. The support policies include export subsidies (ECU 2.2 million in 1994), interest rate subsidies and credit support (farm credits amounted to ECU 26 million in 1994). In addition a Sugar Promotion Fund and a Regional Adjustment Fund for cereals help to subsidise credit rates and fund projects in their respective sectors.

Direct payments exist in the form of diesel fuel subsidies and promotion of high quality breeds and seeds. Altogether they account for a small proportion of subsidies. In 1995 State procurement through the State Grain Bureau was 1% of total domestic grain consumption; the declared target was to establish a grain reserve of up to 60% of total domestic consumption. In a new draft law, which will be passed within short time, this target has been reduced to approximately 3 % of total domestic consumption (three months human consumption of wheat and rye).

Agricultural prices are significantly lower than EC prices (in 1995 e.g: wheat and barley 80.5% and 46.5% respectively of the average EC prices, beef: 49%, milk: 47%), with the exception of pig-meat (24.5% above EC prices). However, milk and meat producer prices are rising in real terms. Consequently livestock production is increasingly profitable. Market support prices similar to CAP intervention prices are not applied in Latvia. In 1995 Latvia spent 5.9% of the total budget on agriculture, which is an increase from previous years.

Rural development policies are receiving increasing attention. The Latvian Government is in the process of implementing a rural diversification programme which includes financial assistance to investments in the rural areas.

Border protection is the predominant support instrument in Latvia. The tariff structure reflects the policy of protecting domestic production.

The Free Trade Agreement between Latvia and the European Community entered into force on 1 January 1995. Reciprocal agricultural concessions are included. Community concessions were improved in 1996 following the implementation of the EU and requested improvements.

In March 1997 Latvia cancelled the quantitative sugar import restrictions and instead automatic licences are granted by the Ministry of Agriculture. Also for grain and cereals new laws eliminating quantitative import restrictions have been submitted to the Parliament and envisaged to be adopted during 1997.

During 1996 the Baltic FTA was extended to agricultural products. This agreement establishes complete free trade of all products meeting the Baltic rules of origin. The Agreement entered into force by 1 January 1997 and is intended to be the first step in the formation of a customs union. Latvia is now negotiating membership of the WTO.

Latvia is beginning to introduce the legislation identified in the White Paper.

Current and Prospective Assessment

Land reform and privatisation is almost complete, whereas the registration of entitlements is lagging behind. A proper land market has not yet been developed, which hampers the necessary structural adjustment. Privatisation is almost complete in the food marketing and processing industry. However, restructuring is relatively slow and industry is very vulnerable to external competition; quality standards and efficiency levels are low by EC standards. As yet neither slaughterhouses nor dairy plants meet EU hygiene standards. The best plants are expected to reach EC standards in 1-2 years. However, as a transitional measure, export of dairy products to the EU is possible.

At present Latvia is not applying any market management policies similar to the Common Agricultural Policy.

This includes key instruments such as dairy quotas, key features of the arable crop scheme (base area, set-aside, compensatory payments, and premia in the livestock sector), as well as rural and structural development programmes. Accession to the EU would imply substantial changes from the current agricultural policies.

Management and control of these measures would require relatively sophisticated administrative systems, including an appropriate land register and cattle identification and registration systems. As a general observation, it is clear that the administrative capacity would need to be further developed in these areas if these measures were to be applied in Latvia.

It is difficult to foresee at this stage what will be the development of agricultural support prices in Latvia in the period before accession; this will depend on a number of factors including the domestic economy, the situation on export markets, and the development of price support levels in the Union.

Latvia is introducing the legislation identified in the White Paper.

Latvia intends to set up a co-ordination division for the harmonisation of national veterinary legislation with EC requirements. Furthermore, it aims at creating a unit to provide veterinary certification in compliance with EC requirements. The government has recognised that further

legislation is required and has set deadlines for approximating legislation ranging from 1 January 1997 to the end of 1999.

Further work is needed on the establishment of a fully resourced official veterinary service, including the imposition of effective controls at border inspection points, and on goods transiting the country. Certification procedures need to be further developed, and an effective animal identification system has to be introduced. Legislation on animal welfare will need to be implemented. There will be a need to upgrade certain food processing establishments both for trade and for the national market. Latvia still vaccinates against classical swine fever and progress to a non vaccination is necessary but may be difficult to implement.

As regards plant health a timetable for approximation to EC legislation has been presented. The Latvian authorities have indicated there may be implementation problems concerning specific measures (e.g. Registration of producers, plant passport system) and infrastructure (e.g. staff training, equipping of laboratories).

Legislation on seeds and propagation material, and quality standards of agricultural seed appears to be only partially consistent with EC legislation and further approximation will be necessary. Latvia does not currently enjoy Community equivalence for any species.

As regards animal nutrition, the current legislation is not compatible with EC legislation. Approximation of Latvian legislation to EC law is in an initial stage. It appears that inspection and control infrastructures will need to be reorganised and upgraded to ensure adequate implementation of the *acquis*. A similar situation exists as regards organic farming, pesticide residues and plant protection products.

Conclusion

Substantial sustained efforts of alignment to the *acquis* are still necessary, although progress has been made in adopting the measures mentioned in the White Paper.

Particular efforts are needed in relation to :

- implementation and enforcement of veterinary and phyto-sanitary requirements, and upgrading of establishments to meet EC standards; this is particularly important with regard to the inspection and control arrangements for protecting the EU external border;
- strengthening of the administrative structures to ensure the necessary capacity to implement and enforce the policy instruments of the CAP;
- further restructuring of the agro-food sector to improve its competitive capacity.

Since only a limited number of the mechanisms of the common agricultural policy presently exist, fundamental reform of the agricultural policy will be needed, and a substantial effort will be necessary to prepare for accession in the medium term.

Fisheries

The Common Fisheries Policy includes common market organisations, structural policy, agreements with third countries, management and conservation of fish resources, and scientific research in support of these activities.

The Europe Agreement includes measures concerning trade in fisheries products with the Community and provides for co-operation. The White Paper includes no measures in this field.

Descriptive Summary

In 1995, 12 000 people were employed in the fisheries sector which equates to 1% of total employment - a third less than in 1990. The 1995 catch totalled 150 000t and landings were valued at 27 million ECU. Fisheries is one of the most important branches of the food industry.

The high-seas fleet consisted of 17 vessels on 1 January 1996 (down from 90 in 1991) and in 1995 caught 91 500t of mostly sardines and horse mackerel from the Central East Atlantic (Mauritania). Before independence, the annual catch was 500 000t of which a large part went to the market in the Soviet Union.

The 171-boat Baltic fleet is privately owned and fishes, under quota, for cod, herring and sprat. The quotas of the latter two species are only half-used and so the catch is not sufficient for the processing branch's needs. 270 boats fish the coastal waters. The total catch of the Baltic amounted in 1995 to 57 000t. The average age of each vessel in the fleet is twenty years. The number of fishing vessels was reduced by 30 % in recent years.

The distant water fleet depends for 80% of its catch on an agreement with Mauritania and exports most of its catch while the Baltic and coastal fleets provide more employment and supply the processing industry.

All 34 enterprises in the processing industry for fishery products are private. Five major plants (more than 500 employees) and the other smaller ones produce a wide range of products. The total employment in the processing industry is 6 336 - outstripping the number in fishing.(5 500)

As aquaculture is concerned, there are eight state-owned farms engaged in restocking, employing 200 people. Private fish farmers are few, but their number is growing. Carp is the traditional species, but rainbow trout is also becoming popular. The total inland water catch was 1 100 tons in 1995.

As a trading partner of the Community, Latvia represents 0.06% of EC total imports (independently of origin) of fisheries products and 2,4% from candidate countries. As regards EC exports, Latvia receives 0.16% of the total exports of fisheries products and 1,9 % to the candidate countries (in terms of value).

Management of the resources in the Baltic is currently accomplished between EU and Latvia in the framework of a common body - the International Baltic Sea Fishery Commission. Latvia has concluded fisheries agreements with Faroe Islands, Russia and the USA.

Current and Prospective Assessment

Latvia's production and foreign trade, when compared to the corresponding EC figures, are low and therefore unlikely to have any significant impact upon the Community as a whole. According to the data available as regards fisheries agreements concluded and Latvia's membership to international or regional fisheries organisations, no major problems should be expected.

The major ports have their own cold stores, but sanitary and hygienic conditions need improving as well as extensive repairs, modernisation and purchase of equipment.

The reduction of the fleet capacity, the modernisation of the whole sector and the determination of the necessary structural aid will become the main issues. It will be necessary for Latvia to establish a fisheries administration which is capable of implementing the Common Fisheries Policy - in particular, the management of resources, the keeping of a fishing fleet register, the application of structural policy for the sector, the management of the market scheme and the collection of all statistical data - as well as the EU's policies on health, hygiene and environmental matters.

Conclusion

The process of modernisation and *acquis* implementation will require significant efforts. In the medium term the fishery sector does not appear to pose any major problem.

Energy

Main EU energy policy objectives, as reflected in the Commission White Paper "An energy policy for the EU" include enhancement of competitiveness, security of energy supplies and protection of the environment. Key elements of the energy *acquis* comprise of Treaty provisions and secondary legislation particularly concerning competition and state aids, internal energy market (including directives on electricity, price transparency, gas and electricity transit, hydrocarbons licensing, emergency response including security stock obligations, etc.), nuclear energy, as well as energy efficiency and environmental rules. Development of Trans-European Energy Networks and support for energy R&D are other important elements of energy policy. Ongoing developments include liberalisation of the gas sector, energy efficiency *acquis* and the Auto-oil programme.

In the field of nuclear energy, the *acquis* has evolved substantially from the original EAEC Treaty to a framework of legal and political instruments, including international agreements. At present, it addresses issues of health and safety, including radiation protection, safety of nuclear installations, management of radioactive waste, investment including EURATOM financial instruments, promotion of research, nuclear common market, supplies, safeguards, and international relations.

The Europe Agreement provides for co-operation to develop the progressive integration of the energy markets in Europe and includes provisions on assistance within the related policy areas. The White Paper preparing CEECs for the internal energy market underlines the need for full application of key internal market directives in combination with EC competition law. As to the nuclear sector, the White Paper refers to nuclear supply safeguards and shipment of radioactive waste.

Descriptive Summary

Latvia depends for more than three-quarters on energy imports, mainly from Russia for oil and gas, but also partly for coal. Some electricity is imported from Estonia, Lithuania and Russia. These import requirements account for an important part of the country's foreign trade deficit (1994: 38%). Domestic resources are being used, mainly wood chips, hydropower and peat which together represent approximately 18% of the country's energy balance.

Energy efficiency is, due to the heritage of low prices, inadequate policies and obsolete technologies, more than two times lower than average EU levels.

With its pipelines and ice-free ports Latvia is a transit country for gas and oil originating in Russia.. However, to operate to the satisfaction of final recipients, Latvia will need to invest in appropriate metering systems. Latvia could provide useful underground gas storage capacity of strategic benefit to the EU.

Better connection of Latvian energy networks to the EU are sought. Although a possible future Baltic electricity ring could contribute to such a connection it is expected that in the short/medium term Latvia will remain linked to the Russian power system. The regional role, for the Baltic region including Kaliningrad, of the Riga load dispatch centre for electricity should be noted.

Latvia only operates one nuclear research reactor in Salaspils and the government accepted to shut this reactor down in 1996. The decommissioning concept for the reactor has been developed.

Current and Prospective Assessment

The declared 1996 energy policy of the Latvian Government, which is in line with EU principles, concerns the restructuring of the energy sector according to market principles, the security of energy supply, a focus on energy efficiency and environmental protection, as well as regional co-operation and co-operation with the EU. Particularly in the energy sector such Baltic co-operation is beneficial due to complementarities among the countries concerned.

The competition framework in the energy sector does not yet fulfil the directives of the internal energy market in combination with the application of EC competition law. The 1991 Competition law and a Law on regulation of entrepreneurial activities in the energy sector (establishing a regulator but needing secondary legislation) are a first step towards EU compliance. Adoption of an energy law which will define the role of major actors in the sector as well as other energy legislation should however be stepped up.

The large companies in the energy sector are, with the exception of the recently privatised Latvijas Gaze, state dominated monopolies, but preparations have started for privatisation of the other main energy companies. Oil, gas and coal import prices are market related, but particularly heat, gas and electricity prices for households are not yet at real cost levels. Unpaid energy bills have led to indebtedness of energy companies but the Government has started to address these difficulties.

Emergency preparedness in the energy sector, including the obligation to hold ninety days of oil stocks, does not comply with the *acquis*, *although preparations for legislation on the matter have started*. With a view to the needed investments it is anticipated that only thirty days can be reached in the next few years. Existing storage capacity, which should be refurbished, could in principle be sufficient to hold the necessary oil stocks.

Latvia will have to make efforts to comply with the *acquis* on energy efficiency (e.g. minimum efficiency norms, labelling household appliances) and environment (e.g. fuel quality standards), although work on these matters has started.

Latvia is a transit country for uranium exports from Russia and the NIS to EU users, and for the import and re-export of uranium sent by EU users to Russia for processing. Fuel for the research reactor came from Russia. If, after the shut down and decommissioning of the research reactor, a last planned spent fuel shipment to Russia is not possible, the fuel will be stored in dry casks on a temporary basis until a definitive solution is found.

Although Latvia has no nuclear power programme, it will need to comply with the Euratom Treaty and related policies in such fields as radiation protection, supply of nuclear materials, safeguards and accession to international agreements concluded by Euratom. As there is no nuclear programme Latvia is not yet party to several international organisations and regimes in the nuclear field.

However, national legislation implementing these regimes is understood to be in place or under preparation. Latvia also has a full-scope safeguards agreement with the IAEA, so in the areas of supply and nuclear common market, no major difficulties in applying Community legislation are expected.

Conclusion

Provided that current efforts are intensified, no major problems are foreseen to approximate progressively to the *-acquis* in the medium term. Of specific importance in the pre-accession period will be the adjustment of monopolies including import and export issues, access to networks, energy pricing, emergency preparedness including the building up of mandatory oil stocks, energy efficiency and environmental norms.

No major difficulties are foreseen for compliance with Euratom provisions, but Latvia should become rapidly party to certain international nuclear regimes.

Transport

Community transport policy consists of policies and initiatives in three fundamental areas:

- Improving quality by developing integrated and competitive transport systems based on advanced technologies which also contribute to environmental and safety objectives.
- Improving the functioning of the single market in order to promote efficiency, choice and user-friendly provision of transport services while safeguarding social standards;
- Broadening the external dimension by improving transport links with third countries and fostering the access of EU operators to other transport markets(The Common Transport Policy Action programme, 1995-2000)

The Europe Agreement provides for approximation of legislation with Community law and co-operation aiming to restructure and modernise transport, the improvement of access to the transport market, the facilitation of transit and the achievement of operating standards comparable to those in the Community. The White Paper focuses on measures for the accomplishment of Internal Market conditions in the transport sector, including such aspects as competition, legislative harmonisation and standards.

Descriptive Summary

Latvia's virtually ice-free Baltic ports meant that it was a significant transit route for trade between the former Soviet Union and the West. As a result, its ports developed capacities for particular trades which are no longer fully exploited. The country's role as a transit corridor between Western Europe and Russia, Belarus and the Central Asian States is however dependent on the state of relations with Russia, which have not always facilitated this traffic. The establishment of new frontiers with Russia and Estonia and Lithuania has also affected the competitiveness of Latvia as a transit route.

Latvia needs therefore to invest in improvements to its East-West rail network and to improve border crossing infrastructures at all the new borders, as well as in its ports. The Latvian territory is crossed by one Pan-European Corridor, as identified at the Pan-European Transport Conference in Crete.

The changes in the Latvian economical patterns have led to a sharp decrease in the transport demand since the opening of the country, although transport is taking an increasing share of GDP. At the same time there is an increasing change in the modal split, with road transport of passengers increasing its share, and railways declining, losing from 1990 to 1995 three-quarters of its traffic level. Use of private cars has grown very rapidly and it is now dominant in passenger transport, resulting in an increase in congestion in the cities and around them, as well as at certain border crossings.

Current and Prospective Assessment

From the point of view of taking over the *acquis* relating to the single market, Latvia has made great efforts, especially in the air transport field. The Latvian international transport sector already applies rules which are largely similar to those of the Union, especially in the field of air transport although progress still has to be made as regards road transport of passengers and goods. The situation in the goods-by-road sector needs to be brought into line with the Community rules from the point of view of access to the profession, driving licences, maximum weights and sizes and road tax. As regards the railways, the effective application of the *acquis* from the point of view of public service and the standardisation of accounting procedures will have to be kept under review for the next few years.

The Latvian Government has set its sights on the development of a competitive and integrated transport system and has drawn up an ambitious programme to this effect. The two main hurdles to be overcome in this field are the attainment of an acceptable level of transport safety, an area in which Latvia has already made encouraging progress, and of an optimum level of use of the transport system, something which the programme is intended to achieve.

As for improved connections with the Member States of the Union and with its neighbours, Latvia intends to invest around ECU 0.3 billion of its own budget between 1995 and 1999 in transport infrastructure used by international traffic, principally the pan-European "Baltic Highway". This amount corresponds roughly to between 1.5% and 1.7% of GNP, which seems a creditable figure.

Conclusion

Latvia is making noteworthy progress in assimilating the *acquis* in the transport field, particular that of air transport. Provided efforts (also as regards the effective implementation of the *acquis*) are made in the goods-by-road, (access to profession, weights and sizes, road tax), shipping (safety) and rail (public service and standardisation of accounting procedures) sectors, the transport industry is unlikely to pose any major difficulties as regards the assimilation of the *acquis* relating to the single market.

By contrast, Latvia would be advised to improve its administrative structures, including inspection bodies such as those responsible for safety, as soon as possible.

Small and Medium Enterprises

EU enterprise policy aims at encouraging a favourable environment for the development of SMEs throughout the EU, at improving their competitiveness and encouraging their Europeanisation and internationalisation. It is characterised by a high degree of subsidiarity. The complementary role of the Community is defined and implemented through a Multiannual Programme for SMEs in the EU. This programme provides the legal and budgetary basis for the Community's specific SME policy actions. The *acquis* has so far been limited to recommendations on specific areas, although legislation in other sectors also affects SMEs (e.g. competition, environment, company law).

The Europe Agreement provides for co-operation to develop and strengthen SMEs, in particular in the private sector, inter alia through provision of information and assistance on legal, administrative and tax conditions. The White Paper contains no specific measures.

Descriptive Summary

As a result of the reform policy towards creating a market economy and supported by the privatisation process, the number of private companies has grown rapidly since the late 1980s. Thus in 1995, small enterprises (0-25 empl.) had 250 000 employees, medium enterprises (25-499 empl.) had 645 000 employees, while large enterprises (more than 500 empl.) had 76 900 employees.

The Ministry of Economy has drafted a National Programme for Small and Medium Enterprises Development which covers the support for entrepreneurship, training and networking, financing, and business incubators. A network of Business Advisory Centres has been established. Further, a regional development policy for the support of entrepreneurship has been elaborated. The Law on Company Income Tax includes a 20% tax reduction for small enterprises fulfilling specific conditions.

Current and Prospective Assessment

The basic structures for SMEs are in place, but there is a need for further refinement of policy, the simplification of legislation to make it more SME friendly, the strengthening of support infrastructures, an improvement of the tax environment and the development of SMEs' access to financing.

To a certain degree, the SMEs are already exposed to considerable pressures from international competition, even on the domestic market. These competitive pressures on the SMEs will become stronger by participation in the internal market. The on-going efforts to strengthen the SMEs during the pre-accession period will therefore need to be continued.

Conclusion

No specific problem areas are expected regarding Latvia's integration into the Community's SME Programmes.

3.5 Economic and Social Cohesion

Employment and Social Affairs

Community social policy has been developed through a variety of instruments such as legal provisions, the European Social Fund and actions focused on specific issues, including public health, poverty and the disabled. The legal *acquis* covers health and safety at work, labour law and working conditions, equal opportunities for men and women, social security co-ordination for migrant workers and tobacco products. Social legislation in the Union has been characterised by laying down minimum standards. In addition, the social dialogue at European level is enshrined in the Treaty Article (118B), and the Protocol on social policy refers to consultation of the social partners and measures to facilitate the social dialogue.

The Europe Agreement provides for approximation of legislation with Community law and co-operation on improving standards of health and safety at work, labour market policies and the modernisation of the social security system. It also provides for Community workers legally employed in Latvia to be treated without discrimination on grounds of nationality as regards their working conditions. The White Paper provides for measures for approximation in all the areas of the *acquis*.

Descriptive Summary

The social dialogue has developed with the participation of both the government, the employer and employee organisations. It normally takes place between one major representative trade union which has regular contacts with the European Trade Union Confederation (ETUC), and two employers' organisations which are not members of the Union of Industrial and Employers' Confederation of Europe (UNICE). The tripartite social dialogue appears to work well while bipartite negotiations need to be improved.

According to ILO methodology, the unemployment rate is 18.3%. Regional disparities are considerable.

On employment policy, Latvia has developed a regionalised employment service to conduct labour market policies. Latvia should be encouraged to strengthen its efforts to adjust its labour market initiatives in order to develop employment systems appropriate for participation in the single European economy.

The new law on social security from 1996 determines the main social rights and obligations of Latvian citizens. Although social assistance - around 11% of GDP - generally covers all residents, the official poverty level is low. The 1996 law provides that social taxes which are now almost exclusively paid by the employers will gradually be paid equally between employers and employees. Laws on compulsory social insurance against work injuries, unemployment as well as maternity and sickness benefits are expected to come into force in 1997. In 1998, Latvia plans to introduce a compulsory pension scheme which will be financed by contributions to a fund. Continued efforts are required to ensure that measures of social protection are developed.

The health system in Latvia needs to be significantly improved.

Current and Prospective Assessment

In 1993, Latvia established a legal framework, taking account of the EU framework directive, to serve as a basis for adopting specific health and safety legislation. These specific legislative initiatives are therefore needed before Latvia can ensure compliance with the *acquis*. The system of labour inspection appears to comply with ILO standards which require independent structures.

On labour law, Latvia is in the process of reforming its Labour Code to bring it into line with EC legislation. This is, in particular, needed in such fields as collective redundancies and protection of workers interests in the event of an insolvency of the employer, in the case of a transfer of an undertaking, information of employees about the working conditions applicable to the work contracts and working time. The information and consultation of workers on company level as requested by a number of EC Directives need to be strengthened.

On equal opportunity, the basic provisions of EC non discrimination law between women and men are covered by Latvian legislation. But the non-discrimination principle is not always respected in areas such as equal pay for equal work and in gender-based advertising. The difference in pay between women and men is considerable.

Concerning the right to the free movement of workers, there would appear to be no obstacles to prevent Latvia from being able to implement the provisions of the *acquis* in this area. The introduction of the right to free movement will however require changes in the national law, particularly as regards access to employment and a treatment free from discrimination on grounds of nationality.

In the field of social security of migrant workers, accession does not, in principle, pose any major problems, although some technical adaptations will be necessary. More important is the administrative capacity to apply the detailed co-ordination rules in co-operation with other countries. Latvia needs to develop the administrative structures required to integrate into the co-ordination system. A great deal of further planning, preparation and training will be necessary in order to prepare their administration for the tasks of co-ordination.

Latvia has not transposed the tobacco Directives on the warning labelling of cigarette packages and the maximum tar content, but legislation covering certain aspects of the tar content, tobacco advertising and smoking restrictions was agreed in December 1996. Latvia is likely to fully comply with EC Directives by 2003 through a progressive harmonisation.

Conclusion

Social reforms should be pursued, and the public health system need to be significantly improved. In addition, the social dialogue needs to be further developed. Latvia will need to make substantive efforts to ensure the realignment of its legislation with EC requirements in areas such as health and safety, labour law and equal opportunities and to continue to develop the structures needed to ensure effective implementation of legislation. Provided Latvia pursues its efforts, it should be possible to take on the obligations of EU membership in the medium term.

Regional Policy and Cohesion

In accordance with Title XIV of the Treaty, the Community supports the strengthening of cohesion, mainly through the Structural Funds. Latvia will have to implement these instruments effectively whilst respecting the principles, objectives and procedures which will be in place at the time of its accession.

The Europe Agreement provides for co-operation on regional development and spatial planning, notably through the exchange of information between local, regional and national authorities and the exchange of civil servants and experts. The White Paper contains no specific provisions.

Descriptive Summary

Latvia was at some 18% of EU average GDP in 1995. Its unemployment seems to have stabilised around 6-7%. Although Latvia is a relatively small country, considerable regional disparities exist; generally, the south-eastern regions are less developed than central districts. Latvia has a rather concentrated urban structure Riga, which is the most populated city in the Baltic States (40% of total population).

Latvia has 26 district authorities and 568 local self governing units (7 cities, 70 towns and 491 rural municipalities). Latvia's districts are characterised by a considerable degree of self-government.

The main problems are :

- low quality of infrastructure, except in the main transit corridors
- pockets of industrial decline or urban crisis
- conversion of former defence activities, in particular in coastal areas
- lack of economic development in the rural areas

Regional policy is implemented under the "Regional Policy development guidelines" ratified by the Council of Ministers in 1995. A new law on regional development is currently under preparation; identification criteria for the support areas is envisaged and the regions identified to start assistance from 1998 for disadvantaged areas. The Regional Development Act clearly stipulates that "regional development policy shall be an integral part of the national development policy". Furthermore, guidelines for national land use should be established on the scale of the whole country.

Latvia's regional development initiatives are implemented through sectoral ministries. While the Ministry of Environment and Regional Development deals primarily with spatial planning, the Ministry of Economy handles regional policy. A Regional Development Council, including representatives from all concerned ministries, participates in the drafting, co-ordination and implementation of regional development initiatives.

Latvia's regional policy expenditure is limited. However, the share of Latvia's total development related expenditure which could constitute potential counterpart funds to the EU structural policy cannot yet be determined. Therefore, Latvia's co-financement capacity cannot be evaluated with sufficient reliability.

Current and Prospective Assessment

Latvia has chosen to maintain regional development within the framework of national development. Nevertheless, a process aimed at providing a legal basis for regional policy has been initiated and substantial progress has already been booked. Thus, within the framework of national development, Latvian authorities seem keen to grant regional perspective a higher priority. However, certain procedures need to be clarified.

The institutional structure and decision-making process would gain from simplification. The division of competencies between the involved institutions should be clarified, the duplication of

powers avoided by concentrating certain tasks within one single body and inter-ministerial co-ordination improved. Finally, a reform of Latvia's administrative sub-divisions should be envisaged.

Conclusion

Latvia manifests a clear political awareness of the need to address rising regional disparities. Given its small size, the decision to maintain regional policy within the framework of the national development strategy seems justified. Clearly, Latvia's needs to improve the administrative structures intended to manage integrated regional development programmes. Yet, its administrative capacity should be able to meet these challenges. Thus, subject to the necessary reforms, Latvia should, in the medium-term, be ready to apply Community rules and channel effectively funds from the EC structural policies.

3.6 Quality of Life and Environment

Environment

The Community's environmental policy, derived from the Treaty, aims towards sustainability based on the integration of environmental protection into EU sectoral policies, preventive action, the polluter pays principle, fighting environmental damage at the source, and shared responsibility. The *acquis* comprises approximately 200 legal acts covering a wide range of matters, including water and air pollution, management of waste and chemicals, biotechnology, radiation protection, and nature protection. Member states are required to ensure that an environmental impact assessment is carried out before development consent is granted for certain public and private projects.

The Europe Agreement stipulates that Latvian development policies shall be guided by the principle of sustainable development and should fully incorporate environmental considerations. It also identifies environment as an area for bilateral co-operation, as well as for approximation of legislation to that of the Community.

The White Paper covers only a small part of the environmental *acquis*, namely product-related legislation, which is directly related to the free circulation of goods.

Descriptive Summary

The scale of environmental problems in Latvia is less severe than elsewhere in the region, because most are concentrated in so-called hot spots and only a limited number of problems is manifested country-wide. Nevertheless, it remains a real challenge to bring Latvian environmental standards up to those of the EU.

Quality of surface waters, especially as a result of urban wastes, is still a problem, but the situation has improved considerably since 1990 with new waste water facilities in Riga and other cities. Apart from traffic related pollution in the Riga area, the situation with regard to air pollution is generally good. Waste management faces the challenges of cleaning up old hazardous waste dumps and of handling increasing amounts of municipal waste. Latvia possesses areas of great natural value, which would represent an asset to the environment of an enlarged Union

Since 1990, substantial progress has been achieved in environmental policy: a new framework law (the Environmental Protection Act in 1991) as well as national long-term plans (the National Environmental Policy Plan, the Environmental Health Action Plan and the very detailed Environmental Action Plan, in 1995-96) have been adopted.

Other legislation has been proceeding more slowly. Supporting regulations have been adopted (e.g. in waste) or are in the process of being drafted. A national resources utilisation tax law has been in place since 1996 and functions well, with the yield earmarked for environmental improvements. There are plans to develop further public participation and economic instruments. However, much of the subsidiary legislation is still old, and greater progress is needed in implementation and enforcement of environmental policy measures, especially by strengthening monitoring and supervision structures. Public spending in environment is relatively low, compared to EU levels.

Latvia has ratified both the 1974 and the 1992 Helsinki Conventions on the protection of the Baltic sea, and has shown commitment to cleaning up Baltic Sea “hot spots”.

Current and Prospective Assessment

All new environmental legislation is intended to comply with the Community *acquis*. A special working group on environment has been set up under the “European Integration Bureau” to ensure compatibility with EC legislation. All White Paper legislation is scheduled to be transposed in the next two to three years. For the remaining legislation an accession strategy is to be developed by early 1998.

Latvia’s target is full compliance to the *acquis* by the year 2005. In order to achieve this, drafting of harmonised legislation and its enforcement are needed in air pollution, chemicals and nature protection. In radiation protection there is generally a lack of safety culture. Latvia is now preparing legislation on water quality objectives. Particular attention should be given to the quick transposition of framework directives dealing with air, waste, water and the Integrated Pollution Prevention and Control (IPPC) directive, as well as the establishment of financing strategies for legislation in the water, air and waste sectors requiring major investments.

On the basis of current plans and performance, major progress in the field of legal compliance is likely to be made in the next few years.

Concerning effective compliance to the EC environmental *acquis*, the main long-term problems are the need for investment in infrastructure, especially in the water and waste water sectors outside the big cities, and the enforcement of legislation. A key concern is the severe lack of human and financial resources to conduct the approximation process. An important bottleneck which needs to be addressed is the lack of human resources with expertise to conduct the approximation process. The country’s environmental accession strategy should include implementation timetables for meeting the EC environmental *acquis*, starting amongst others with implementation of the framework and IPPC directives mentioned above.

Conclusion

With the current pattern and speed of reforms in Latvia, full transposition of the environmental *acquis* should be achieved in the medium term. However, effective compliance with a number of pieces of legislation (e.g. urban waste water treatment, drinking water, aspects of waste management and air pollution legislation) could be achieved only in the long term and will require a significant increase in environmental investment, as well as a major effort to reinforce the administrative capacity.

Consumer Protection

The Community *acquis* covers protection of economic interests of consumers (including control of misleading advertising, indication of prices, consumer credit, unfair contract terms, distance selling, package travel, sales away from business premises and timeshare property) as well as the general safety of goods and the specific sectors of cosmetics, textile names and toys.

The Europe Agreement provides for approximation of legislation with Community law and co-operation with a view to achieving full compatibility between the systems of consumer protection in Latvia and the Community. Stage I measures of the White Paper focus on improving product safety, including cosmetics, textiles and toys, and on the protection of the economic interests of consumers, notably measures on misleading advertising, consumer credit, unfair contract terms and indication of prices. Stage II measures relate to package travel, sales away from business premises and time-share property. New EC legislation which has been adopted recently (distance selling) or will be adopted soon (comparative advertising, price indication) will also need to be taken into account.

Descriptive Summary

The law on the Protection of Consumers was agreed in 1992 and sets out the rights of consumers and the obligations of manufacturers, sellers and service providers in ensuring quality, correct advertising, and safety of goods. The Act further establishes the responsibility for violation of consumer rights, and defines the role of non-governmental organisations working in the field of consumer protection. The role of such organisations is limited by the lack of resources.

In order to improve the quality and safety of products and services as well as to develop and carry out the protection of consumer rights, the government adopted a "Consumer Rights Protection Programme" in June 1995.

The overall responsibility for consumer affairs lies with the Ministry of Economy, although its role is not defined in the Consumer Protection Act. Other bodies involved in consumer protection are the Trade Supervision Committee and the Anti-Monopoly Committee.

Current and Prospective Assessment

Despite considerable progress, the existing legislation for consumer policy in Latvia only to a limited extent complies with the *acquis*. Concerning the protection of economic interests of consumers, there appear to be no laws regulating sales away from business premises, distance selling, timeshare property and consumer credit. Amendments are required in the area of misleading advertising and unfair contract terms while new draft legislation is under preparation for package travel and indication of prices.

A new law was agreed in late 1996 on the general safety of products and services and on product and services liability. Although this law largely implements the Directive on general product safety, some additional amendments are required to ensure full compatibility with EC standards, mainly because the law fails to give adequate powers to the public authorities. Concerning the specific sectors, a framework law on the labelling of consumer products is under preparation. Once agreed, a law on textile labelling will be put forward. There appears to be draft legislation underway on cosmetics and the safety of toys which would amend existing laws and bring them into line with EC requirements.

The development of a strong and independent consumer movement, sustained by public authorities, will need to accompany the introduction of the *acquis*.

Conclusion

Latvia will need to continue reform in the field of consumer protection since the existing legislation needs to be substantially adjusted, or new laws brought forward, before Latvia satisfies EC requirements on consuming. There is also a need for more efficient institutional structures to ensure the application of legislation. But, taking on the consumer protection *acquis* in the medium-term is not expected to cause major problems for Latvia.

3.7 Justice and Home Affairs

The Present Provisions

The Justice and Home Affairs (JHA) *acquis* principally derives from the framework for co-operation set out in Title VI (Article K) of the Treaty on European Union (TEU), "the third pillar", although certain "first pillar" (EC Treaty) provisions and legislative measures are also closely linked.

The EU JHA framework primarily covers: asylum; control of external borders and immigration; customs co-operation and police co-operation against serious crime, including drug trafficking; and judicial co-operation on criminal and civil matters.

The TEU stipulates key principles upon which such co-operation is based, notably the European Convention on Human Rights and the 1951 Geneva Convention on the Status of Refugees. It is also based implicitly on a range of international conventions concerning its fields of interest, notably those of the Council of Europe, the United Nations and the Hague Conference. The legislative content of third pillar *acquis* is different from the first pillar; it consists of conventions, joint actions, joint positions and resolutions, (including the agreed elements of draft instruments which are in negotiation). A number of EU conventions (including the 1990 Dublin Convention, and conventions relating to extradition, fraud and EUROPOL) have been agreed by the Council and are now in the process of ratification by national Parliaments; several other conventions, including one on external frontiers are in various stages of negotiation in the Council. The JHA *acquis* involves a high degree of practical co-operation, as well as legislation and its effective implementation.

The New Treaty

For many of the above matters, the entry into force of the Treaty resulting from the Amsterdam Inter-Governmental Conference will mark the end of the current cooperation framework.

Reiterating the objective of developing the Union into an "area of freedom, security and justice", the new Treaty brings these matters, including the free movement of persons, asylum and immigration, into the Community's sphere of competence.

On the free movement of persons in particular, the new Treaty provides for the incorporation of the Schengen *acquis* into the framework of the European Union and binds any candidate for EU membership to accept that *acquis* in full.

With regard to matters remaining within the cooperation framework, i.e. policing and criminal justice, the new Treaty provides for the reinforcement of the cooperation system.

The Europe Agreement and the White Paper

The Europe Agreement includes provision for co-operation in the fight against drug abuse and money laundering.

The White Paper does not deal directly with third pillar subjects, but reference is made to first pillar matters such as money laundering and freedom of movement of persons which are closely related to Justice and Home Affairs considerations. Reference is also made to the Brussels and Rome conventions.

Descriptive Summary

General Preconditions for JHA Co-operation

Latvia joined the Council of Europe in 1995 and has ratified the European Human Rights Convention. The Constitution provides for an independent judiciary according to the rule of law. Latvia has not yet ratified the 1990 data protection convention. (See also separate section on Single Market). Progress has been made in institutional reform of JHA institutions, but in general terms Latvian JHA institutions still suffer from significant deficiencies in personnel, finance and management systems.

The Government has recently set up a Third Pillar integration coordination group under the Prime Minister to address these issues.

Asylum

Latvia ratified the 1951 Geneva Convention in June 1997 and has adopted a law concerning asylum seekers. A new reception centre for asylum seekers and refugees, in Mucenieki, is under development, designed and supported by UNDP and UNHCR.

Immigration/Border Control

Latvia has visa-free agreements with the UK, Ireland, Denmark and Iceland, and such arrangements are about to come into force with Norway, Sweden and Finland. Visa-free arrangements also exist with a number of central European countries, and with Lithuania and Estonia, with which it operates a visa-free travel zone. Latvia has adopted the EU third country list for which visas are required. Latvia's admission policy is strict. A new population registration system is now in place, also for the issuing of new passports for Latvian citizens and resident non citizens. Latvia has readmission agreements with Estonia, Lithuania, Denmark, Sweden, Finland and Iceland, and is preparing such agreements with Italy, Norway, France, Portugal and others.

There is no formal bilateral agreement with Russia on readmission. Border management systems on the Eastern frontier are ineffective and need substantial upgrading of the human resource and technical resources. The Government transferred responsibility for the border guard from the Defence to the Interior Ministry in January 1997, resulting in significant improvements.

Police Cooperation

Organised crime exists in Latvia in the fields of drug trafficking, trafficking in women, prostitution, and smuggling; violence and extortion are used. The Police Bureau, working closely with the security police, has been set up to tackle organised crime more effectively. New laws are being planned to protect witnesses, tackle financial crime and money laundering. A major training effort is underway for the police forces. Latvia is preparing the necessary domestic legislation for

accession to the 1990 money laundering convention, important parts of which have already been implemented through other legislation. (See also separate section on Single Market). There is no threat from terrorism.

Drugs

Latvia is a minor transit country for drug trafficking. Drug seizures were insignificant in 1996, but the resources devoted to the task were very limited. Domestic use is growing and there is now a domestic production of synthetic drugs. Latvia has ratified the main international conventions on drugs (except money laundering - see above) and has put in place domestic legislation on narcotic drugs and precursors. Latvia has set up a Narcotics Control Committee, which is developing a policy in line with the programmes of the UN and the WHO. The police have set up a special programme for combating drugs.

Judicial Cooperation

The Latvian judiciary has significant problems relating to inexperience and resource constraints. Nevertheless the Government has begun to prepare the judiciary for EU membership. Latvia has recently ratified the main criminal conventions (Extradition, Mutual Assistance, Transfer of Sentenced Persons) and has ratified a number of Hague Conventions. Latvia has also begun a reform of the court system, aimed at its development and technical provision, and improvements in the training and position of the judiciary. Latvia's participation in international co-operation is focused on Interpol and the neighbouring states conventions.

Current and Prospective Assessment

Important gaps still have to be filled in Latvia's legislation and implementation systems; progress has been significant but uneven. Measures are being taken to improve border management, asylum policy and measures against organised and financial crime.

The main institutional problems lie in the field of resource constraints and lack of experienced personnel, as well as management weaknesses leading to inefficiencies and some corruption. The border management systems are a matter of particular concern. More Latvian officials need to have experience of practical co-operation with EU JHA counterparts. The Government is working to prepare the institutions for participation in the JHA process.

Conclusion

Latvia is starting from a low base in the JHA field and faces considerable institutional problems in preparing itself for effective co-operation with EU JHA institutions. A major, sustained effort will be required if Latvia is to have the possibility of meeting the justice and home affairs *acquis* (present and future) in the medium term.

3.8 External Policies

Trade and International Economic Relations

The *acquis* in this field is made up principally of the Community's multilateral and bilateral commercial policy commitments, and its autonomous commercial defence instruments.

The Europe Agreement includes provisions in several areas requiring parties to act in accordance with WTO/ GATT principles, or other relevant international obligations.

The White Paper includes no provisions in this field.

Descriptive Summary

Latvia has developed an open, trading economy and is expected to become a member of the World Trade Organisation (WTO) by the end of 1997. Latvia has observer status in the Government Procurement Agreement and, upon accession would have to comply with the obligations of the plurilateral WTO agreements to which the Community is a party.

At present Latvia does not maintain quantitative restrictions on any textile or clothing products. On accession the Community textiles policy would be extended to Latvia; any Community restrictions still maintained at the date of accession would require adjustment by an appropriate amount to take account of Latvian accession.

Current and Prospective Assessment

On accession Latvia would have to apply the Community's Common Customs Tariff, and the external trade provisions of the Common Agricultural Policy. The post Uruguay Round weighted average level of most favoured nation duties for industrial products will be 3.6% for the Community. The level for Latvia is expected to be closely aligned to the Community Common Customs Tariff.

In its relations with international organisations Latvia should ensure that its actions and commitments respect the Europe Agreement and ensure a harmonious adoption of its future obligations as a member of the Community.

On accession Latvia would become party to the Community's various preferential agreements. Preferential agreements between Latvia and third countries would, in general, have to be terminated on accession.

In the area of trade in services and establishment, Latvia has sought to keep its multilateral commitments under GATS as consistent with those of the Community as possible during its negotiations to join the WTO. It should be possible to resolve any remaining, significant inconsistencies.

On accession Latvia would have to repeal national legislation in the field of commercial defence instruments, and EC legislation would become applicable there.

Experience from previous accessions has shown that the automatic extension of existing anti-dumping measures to new member states prompts third countries to raise problems in terms of the compatibility of this approach with relevant WTO provisions. It has also shown that accession creates a potential for circumventing measures adopted by the Community under the commercial defence instruments. This happens when, prior to accession, substantial quantities of the products subject to measures are exported to the territory of the future member state and, on accession, are automatically released for free circulation in the enlarged customs territory. These two problems would have to be addressed during Latvia's pre-accession phase.

Latvia is not a member of any non-proliferation regime, although it has expressed interest in membership. The Latvian control list of dual-use items is a direct translation of the Community control list. Arms export is also controlled. There appears to be no obstacle in principle to Latvia applying Community legislation in this field.

Conclusion

Latvia is well placed to be able to meet Community requirements in this field within the next few years.

Development

The *acquis* in the development sector is made up principally of the Lomé Convention, which runs until early 2000.

Neither the Europe Agreement or the White Paper include provisions in this field.

Descriptive Summary

Latvia has a number of trade agreements with Least Developed Countries, based on Most Favoured Nation treatment. No GSP schemes apply in Latvia, and no duty free access is granted.

Latvia has no budget for development aid.

Current and Prospective Assessment

On accession, Latvia should apply its preferential trade regime to the ACP States and participate, together with the other member states, in financing the European Development Fund (EDF), which provides financial aid under the Lomé Convention.

Applying the Lomé trade regime should not generally be a source of difficulties for Latvia.

Normally, new member states accede to the Lomé Convention by means of a protocol on the date of their accession to the EU.

Conclusion

Latvia should be able to meet EU requirements in this field in the next few years.

Customs

The *acquis* in this sector is the Community Customs Code and its implementing provisions; the EC's Combined Nomenclature; the Common Customs Tariff including trade preferences, tariff quotas and tariff suspensions; and other customs-related legislation outside the scope of the customs code.

The Europe Agreement covers the establishment of a free trade area with the Community and the progressive removal of customs duties on a wide range of products, according to clear timetables starting from the date of entry into force of the agreement.

The White Paper includes in Stage I, measures to consolidate and streamline the free trade established under the Europe Agreement, including legislation compatible with the Customs Code, Combined Nomenclature, etc. Stage II concerns the adoption of the full Community legislation, with a view to joining the customs union upon accession.

Descriptive Summary

On accession the Latvian customs authorities would be required to assume all the responsibilities necessary for the protection and control of their part of the EU's external border. Besides the provisions on indirect taxation, they would be responsible for the implementation and enforcement at the external border of the Community's common commercial policy, the common agricultural policy, the common fisheries policy etc.

Latvia's capacity fully to apply the *acquis* presupposes the possibility to adopt and implement the Community legislation; and the existence of an adequate level of infrastructure and equipment, in particular in terms of computerisation and investigation means and the establishment of an efficient customs organisation with a sufficient number of qualified and motivated staff showing a high degree of integrity.

The legislation in force as well as the customs-related legislation outside the scope of the customs code has not been EC compatible. But with the support of technical assistance provided by customs programmes, Latvia has prepared a customs code harmonised with the Community's customs code and its implementing provisions.

Latvia has almost aligned its national goods nomenclature to the Community's Combined Nomenclature. However, at this stage the Latvian administration does not have an integrated tariff, which will make the comparison of the Latvian tariff rates with the Common Customs Tariff rates difficult. In addition, Latvia will have to be familiarised with the methodology of the Binding Tariff information system used in the EC.

Latvia adopted on 1 April 1997 the new system of cumulation of origin between European countries.

Latvia has applied to become a contracting party to the EC/EFTA Common Transit Convention and the Single Administrative Document Convention. A Community Task Force is assisting Latvia in this field, but development is hindered by difficulties in the area of guarantees. Accession to the Transit Convention will require a period of considerable further preparation.

Current and Prospective Assessment

Latvia would need to adapt its national procedures to the Community legislation regarding suspensive arrangements and customs procedures with economic impact. At the moment of accession, some technical transitional arrangements would be needed, notably for operations beginning before the date of accession but which are concluded after that date.

Presently, Latvia does not operate a system of tariff suspensions. This raises serious concern in relation to its capacity to cope with the complexity of the Community mechanism in these domains.

It will be important that the Latvian customs authorities can participate appropriately in the various computerised systems necessary for the management, in the customs union/internal market, of the customs and indirect tax provisions, as well as the computerised systems for mutual administrative assistance in customs, agricultural and indirect tax matters. Computerisation is at a very preliminary stage of development in Latvia.

Latvia would need on accession to dismantle customs controls at the borders with EU member states and with other acceding countries. The resources needed for the reinforcement of the border

posts along its frontiers with non-EU member states should be taken into account in its strategic planning.

Conclusion

Latvia will need to continue major efforts to align its legislation, organisation and staff to the duties that have to be carried out by a modern customs administration. If it does so it may be able to meet EC requirements in the medium term.

Common Foreign and Security Policy

Since regaining its independence in 1991, Latvia has orientated its foreign and security policy towards the EU and NATO. Successive government declarations have confirmed membership of Euro and Euro-Atlantic structures as the principal aim of Latvian foreign policy. Latvia has been an active participant in the dialogue arrangements provided for under the Union's Common Foreign and Security Policy and whenever invited has supported EU actions within that framework.

Latvia is a member of the UN, OSCE, Council of Europe and many other international organisations. It is an associate partner of WEU, participates in the NACC, the PfP and has made clear its desire to become a member of the WEU and NATO as soon as possible. It has sent troops to participate in IFOR/SFOR. Latvia strives to contribute to regional stability through active co-operation in the Baltic Sea region, in particular in the work of the Council of the Baltic Sea States and in organisations for Baltic-Nordic co-operation. It is considering applying for membership of CEFTA.

There are no territorial disputes between Latvia and any member state of the Union. Neither does it have any major disputes with neighbouring associated countries, although an agreement concerning the maritime border with Lithuania remains outstanding.

The maintenance and development of good relations with Russia is one of the main foreign policy priorities of Latvia. An important achievement was the withdrawal of Russian troops from Latvia, with the exception of the limited force which will guard the Skrunda radar station until 1998, under OSCE monitors.. An important remaining issue between Latvia and Russia is the absence of a border agreement, but progress was made in negotiations following the Latvian decision not to insist on Russian recognition of the validity of the 1920 Peace Treaty. Since March 1997 there is draft agreement on a frontier line which follows the existing control line. The Latvian government has expressed its readiness to sign the agreement as soon as Russia is ready to do so.

The border agreement between Latvia and Belarus has been signed but the physical demarcation of the frontier remains to be completed.

Latvia has a new and small diplomatic service with limited experience and resources. In due course, it should nevertheless be able to play a full role as a member of the Union. It maintains 26 representations abroad and employs 226 diplomatic staff.

Latvia supports non-proliferation of nuclear, biological and chemical weapons and is a signatory, or candidate member, to all relevant international arms control agreements. It does not manufacture or export weapons. The small Latvian armed forces, which are being brought under democratic control, are being reorganised to meet NATO requirements. Latvia participates in the Baltic peacekeeping battalion (BALTBAT) and played host to a major PfP exercise (Baltic Challenge) in 1996. Latvia has no defence industrial base.

In the statement accompanying its application for membership of the Union, Latvia confirmed that it was ready and able to participate fully and actively in the Common Foreign and Security Policy.

The assessment of Latvian foreign and security policy to date leads to the expectation that as a member it could fulfil its obligations in this field.

3.9 Financial Questions

Financial Control

The implementation of Community policies, especially for agriculture and the Structural Funds, requires efficient management and control systems for public expenditure, with provisions to fight fraud. Approximation of legislation is moreover needed to allow the system of “own resources” to be introduced, with satisfactory provision for accounting.

The Europe Agreement provides for cooperation in audit and financial control, including technical assistance from the Community as appropriate. The White Paper includes no measures in this field.

Descriptive Summary

As provided for by the State Audit Act of 1993, the State Audit Office is an independent, collegiate institution controlling the collection and expenditure of the State and local government budgets as well as special budget resources. The Office presents its observations and recommendations to the Parliament.

The State Audit Office is a member of the International Organisation of Supreme Audit Institutions as well as the European Organisation of Supreme Audit Organisations.

The Management Audit Council supervises the internal audit systems in all public institutions. Several Ministries (such as Transport and Agriculture) have their own internal audit systems.

Budgetary control is provided by the Ministry of Finance and State Treasury Department.

The State Revenue Service, under the Ministry of Finance, secures the collection of taxes, duties and other fees.

Current and Prospective Assessment

Given that the EU agricultural expenditures, Structural Funds and “own resources” are quite different from current systems in Latvia, the establishment of the necessary management and control mechanisms will require considerable preparation.

With respect to “own resources”, particular attention will need to be given to such fields as levies duties, time limits for the incurrence of customs debt, notification of the debtor, and the accounting procedure.

Conclusion

Substantial preparations will be needed to establish the necessary management and control mechanisms to cope with EU requirements. However, if the necessary initiatives can be taken in this respect, this field does not appear to represent a major obstacle, in the medium term, for Latvia’s accession.

Budgetary Implications

The communication entitled "Agenda2000" sets out the overall financial framework which should accommodate the budget impact of any future enlargements in the medium term. This is to ensure that any enlargement is compatible with proposed Community policy guidelines within reasonable budget limits.

As things stand, it would be difficult, not to say premature, to attempt precise country-by-country evaluations of the budgetary implications of each of the applicants joining the Union. Exactly what the impact would be may vary considerably depending on a whole series of factors:

- the date on which the applicant country joins;
- developments in Community policies between now and then, in particular the decisions to be taken on further reform of the common agricultural policy and new guidelines for structural measures;
- the progress made by the applicant countries in terms of growth, increasing their competitiveness and productivity and their ability to absorb the *acquis*;
- the transitional measures that will come out of the negotiations.

Only a few orders of magnitude for certain budget categories and an overall estimate can be given, purely as a guide.

Expenditure

If the common agricultural policy were to be reformed along the lines suggested by the Commission, once the reforms were fully up and running and in terms only of market intervention measures, Latvia's accession would give rise to only marginal additional expenditure in relation to likely expenditure on the present fifteen Member States.

After a phasing-in period, allocations for structural measures in Latvia would account for no more than around 4% of its GNP.

Application of the other internal Community policies in the new member countries would be likely to involve additional expenditure probably in excess of their relative proportion of Union GNP, since for certain policies the additional implementing costs also depend on the target population, the geographical area covered or the number of Member States involved in the coordination and harmonisation measures. The GNP of Latvia is currently less than 0.1% of total Union GNP.

By contrast, Latvia's accession should not involve significant additional expenditure as far as Union external action is concerned.

It should not be forgotten that when an applicant country joins, the Community budget will no longer have to bear the costs of grants the country was eligible for under the various pre-accession programmes, such as PHARE.

In the light of the above, the estimated costs in the three areas mentioned arising from Latvia's accession should fall within the range of, annually, ECU 0.4 billion to ECU 0.5 billion in 2005-06 (at constant 1997 prices).

Revenue

Assuming full application of the own resources system, the new members' contributions to the Community budget should, in terms of total GNP and VAT resources (taking account of the capping rules applying to VAT), be close to the proportion of the Union's GNP they account for, which in Latvia's case is less than 0.1%. Latvia's portion of traditional own resources will depend on the structure of its trade flows at the time of accession.

To ensure that the own resources are established, monitored and made available in line with Community regulations, Latvia will have to overhaul its current customs system. In addition, for the purposes of accurately calculating the GNP resource considerable improvements will have to be made to the national accounts to ensure that they are reliable, homogeneous and complete. Improving the statistics will also be essential for drawing up the VAT own resources base, which will mean bringing Latvia's VAT system fully into line with the Community directives.

4. Administrative Capacity to Apply the *Acquis*

The European Council in Madrid in December 1995 concluded that the harmonious integration into the EU of the central and eastern European applicant states would, in particular, require the adjustment of their administrative structures. This chapter examines the current state of the public administration in Latvia, including relevant aspects of the judicial system, and assesses the current and prospective ability to carry out the functions required of it in a modern, democratic state, with a particular focus on the need to administer matters related to the *acquis*.

4.1 Administrative Structures

A description of Latvian constitutional structures, their powers and responsibilities, including those of regional and local government, is given in Chapter 1.

At the central level there are 12 ministries, the Prime Minister's state chancellery and a number of bodies of equivalent importance such as the European Integration Council which coordinates matters related to EU accession.

A Civil Service Law was enacted in 1994. It determines the status, rights and responsibilities of civil servants.

The principle of political independence of the civil service is recognised in Latvia, although senior positions are not always free of party political influence.

There are approximately 13,600 civil servants employed in Latvia (including 4,200 customs staff). Salaries available in the private sector are far higher than in the public sector. Many civil servants supplement their incomes from other employment.

Administrative reform gained momentum after the national election in 1993. A Civil Service Administration Unit, and Latvian School of Public Administration were established in December 1993 in order to implement the Civil Service Law as well as an Ethics Council for solving ethical issues and conflicts of interests affecting state officials. In July 1995 the central government reform function was transferred to the State Reform Department of the State Chancellery. The issue of reform of local and regional administration was referred to the Ministry of Regional Development and Environmental Protection.

Latvia has established a special institutional framework for handling European integration issues, comprising the European Integration Council on a ministerial level. (See also the section of the Introduction concerning relations between the European Union and Latvia).

4.2 Administrative and Judicial Capacity

Latvia was part of the Soviet Union until 1991 and administered under central planning until then. The communist system rejected the primacy of the rule of law and subjugated the law and the administration to the implementation of Party policy. Against this background, both the administration and the rule of law itself increasingly came to be seen by the public as instruments of political control.

The public administration requires further structural reform. A systematic programme has been in place since 1993. At central government level the structure is broadly modelled on Nordic/ western European systems.

The planned Public Administration Bureau should have a useful role to play.

The efficiency and cohesion of ministries varies widely, from good to very poor. Lack of able and experienced staff presents a major problem for all ministries.

The legal basis for the civil service is adequate. But it will be important for Latvia's longer term development that a genuine tradition and practice of political independence in the civil service develops.

Both under- and over-staffing exist in the public administration. But the problems lie not so much in that aspect as in lack of experience. There is a problem of "brain drain" to the private sector, but this is not as great as might have been expected given the difference in salary levels.

Public confidence in the civil service is not assured, especially at the local government and town council level. Part of this is due to public concern at the incidence of corruption. The Government is conscious of a significant and widespread problem of corruption in the public administration. An anti-corruption programme was established in 1993. A Law on Prevention of Corruption has been in force for a year. Several cases have been brought.

The wide-ranging training initiatives put in place by the Government will need to be considerably reinforced to meet the needs of Latvia in the context of its progress toward EU accession, and more generally the continued successful development of the Latvian state. Training needs exist both at the central and local levels, notably in management and human resources. Various bodies have been set up through which these goals could be pursued.

The European Integration Council has created a functioning structure for decision-making on EU matters. The EIB is well organised and has reinforced its staff in 1997. There is a good case for the coordinating function of the EIB to be strengthened to give it greater authority over sectoral ministries. The scarcity of experts is a problem; for example, in some cases the same lawyers who have drafted laws for individual ministries are then responsible for scrutinising the drafts in the working groups.

Key Areas for Implementation of the Acquis

The uniform application of EC law: The effective application of the *acquis* presupposes that the judicial authorities of member states are able to apply the provisions of the Treaty dealing with ensuring the unity and application of the *acquis*, and are able to ensure the proper functioning of the Single Market and Community policies in general. A high quality and well trained and resourced judiciary is necessary for the application by the courts of EC law, including cases of direct effect, and cases of referral to the European Court of Justice under the terms of Article 177 EC.

The judicial system in Latvia suffers has important weaknesses, particularly concerning resources, and relevant expertise. Given this situation, the Commission has significant doubts about the ability of the system to ensure the effective application of the *acquis*.

Single market: The ability of Latvia to ensure the correct application of Community requirements in the Single Market, particularly concerning the free movement of goods and services presupposes the existence of highly developed and effective regulatory, standardisation, certification and supervisory authorities, able to act fully in accordance with EC rules. An analysis of these points is made in Chapter 3.1 (under "The Four Freedoms").

Concerning the administrative capacity in respect of free movement of goods the situation in Latvia is not yet satisfactory. Despite good efforts made in the fields of standardisation and conformity assessment, the regulatory agencies suffer from serious under staffing problems. The Centre for Standardisation and Metrology has only 152 staff, and other agencies considerably less. Concerning the free movement of services the situation is much improved following the strengthening of the supervisory capacity of the Latvian Central Bank (700 staff). An Insurance Supervisory Committee (20 staff) is in the Ministry of Finance. A Securities Market Commission (12 staff) has also been created.

In order to meet EC requirements in this area all regulatory bodies need improved staffing and training.

Competition: As explained in Chapter 3.1 (under "Competition") enforcement of competition law requires the establishment of anti-trust and state aid monitoring authorities, and that the judicial system, the public administration and the relevant economic operators have a sufficient understanding of competition law and policy.

In Latvia the central authority is the State Anti-Monopoly Committee which has 88 staff; this is adequate. The level of expertise is appropriate. Nonetheless, the ability effectively to implement EC requirements in this field will require the full independence of the competition authority, and some further investment in human resources.

Telecommunications: In order to formulate and implement the many liberalisation regulations contained in the *acquis* in this field it is necessary to have a regulatory and policy making body that is effectively separated from any operating company.

In Latvia two independent regulatory bodies exist; the Department of Communications of the Ministry of Transport (telecommunications and postal services) and the Telecommunications Tariff Council (5 staff). In 1966 a new regulatory department, the Department of Informatics, was established at the Ministry of Transport to deal with information society matters. Both bodies are independent organisations, separated from the public telecommunications operator and are financed by the state budget. However, it is to be doubted whether sufficient administrative capacity exists.

Indirect taxation: The effective administration of the indirect taxation *acquis* presupposes structures capable of implementing the EC legislation concerning the harmonisation of Valued Added Tax and excise duties in an environment in which fiscal controls at internal EU frontiers have been abolished; and the excise system is based on the tax warehouses, duty being payable at the local rate in the member state at the time the goods are consumed. This requires a highly developed and well trained and resourced service, with a high degree of integrity.

In Latvia the relevant authority is the Ministry of Finance. The total number of staff in the State Revenue (Income) Service is 4 100. Due to a large turnover of staff, resulting partly from trained staff being recruited by the private sector, it is difficult to estimate the capacity of existing staff. In order to ensure the effective administration of the *acquis* in this area it will be necessary to consolidate and improve the overall professional standards of the staff, including training measures and improvements in pay.

Agriculture: The administrative requirements in the agricultural area primarily concern veterinary and phyto-sanitary control, to protect public health and ensure the free movement of agricultural goods; and the ability to administer the mechanisms and requirements of the CAP, including high standards of financial control and official statistics. These points are dealt with in Chapter 3.4 (under "Agriculture"); general standards in the statistical field are examined in Chapter 3.3 (under "Statistics").

Concerning the administrative capacity in respect of veterinary and phyto-sanitary controls, further work is required in Latvia on the establishment of a fully resourced official veterinary service, including the imposition of effective controls at border inspection points, and on goods transiting the country. There are 26 district veterinary offices, each with between 3 and 8 inspectors. There are about 80 full-time food inspectors. Concerning the administration of general CAP requirements, a substantial adaptation of the current administrative structure will be necessary.

In order to meet EC requirements in this area considerable improvements will be required.

Transport: The application of the EC Internal Market and competition requirements to the transport sector, the development of relevant infrastructure products, and other aspects of the transport *acquis* will present administrative challenges to new member states.

The responsible government authority in Latvia is the Ministry of Transport with a total of 95 staff. Within the overall institutional reorganisation of the transport sector, priority is being given to the introduction of modern management and budget practices. There is, however, a shortage of qualified staff. This raises particular concerns with regard to the enforcement of safety controls.

Employment and social policy: A central administrative requirement in respect of the *acquis* in this area is adequate inspection capacity, particularly concerning health and safety at work.

In Latvia the labour inspectorate has about 60 staff, and requires considerable reinforcement of staff resources and expertise.

Regional policy and cohesion: The main administrative requirements in this area are the existence of appropriate and effective administrative bodies, and in particular a high degree of competence and integrity in the administration of Community funds.

In Latvia regional development is handled by the Ministry of the Economy. The number of staff employed is not currently available to the Commission. (The Ministry of Environment and Regional Development (70 staff) deals with spatial planning). These arrangements can be considered

generally appropriate. The situation concerning financial control is not yet satisfactory (see the section, below, on "Financial control"). The effective administration of the *acquis* in this area will require some administrative reforms.

Environment: Because EC environmental policy involves the integration of environmental protection into EC sectoral policies, the administrative requirement is potentially very wide, affecting many bodies not normally associated with environmental protection. However, the main responsibility lies with environment ministries and various subsidiary bodies.

In Latvia the Environment Ministry employs 120 staff. Monitoring is carried out by the Environmental Consulting and Monitoring Centre, enforcement by the Ministry and 9 regional committees. These arrangements are adequate. The effective administration of the *acquis* in this area will require greater financial and human resources, especially as legislation is progressively approximated.

Consumer protection: In this area, the effective administration of the *acquis* requires the allocation of overall responsibility to a specific State body through which the formulation, implementation and enforcement of consumer policy and consumer protection legislation can be undertaken.

In Latvia the governmental Department of Quality Management and Structural Development has been given full authority to develop and implement consumer protection policy. As regards non-governmental consumer bodies these remain far too weak. There remains confusion about the exact scope and objectives of consumer policy. This in part explains difficulties in the effective enforcement of consumer laws; however, other factors which need to be addressed include a lack of expert staff, organisational deficits, and a lack of sensitivity to consumer questions among the judiciary.

Justice and home affairs: Oversight of justice and home affairs questions falls to the justice and interior ministries. The administrative structures need to be able to deal effectively with asylum and migration questions, border management, police cooperation and judicial cooperation. There is an overriding need for sufficient and properly trained staff with a high degree of integrity.

In Latvia the justice and interior ministries are adequately staffed. The capacity to handle asylum and migration is not yet assured. Border management systems on the eastern frontiers are ineffective and need substantial human and financial resources. Specialised police units have been created, and a major training effort is underway. Reform of the court system has begun; judicial cooperation is currently focused on neighbouring states. The effective administration of the *acquis* in this area will require further investment in technical and human resources, improved management, steps to combat corruption, and greater experience of practical JHA cooperation with EU counterparts.

Customs: Applying the *acquis* in this area requires an adequate level of infrastructure and equipment, including computerisation and investigation resources, and the establishment of an efficient customs organisation with a sufficient number of qualified and motivated staff showing a high degree of integrity.

In Latvia the customs service employs 1 675 staff. Due to a high turnover of staff, it is difficult to estimate their efficiency, and therefore the adequacy of staffing levels. The effective administration of the *acquis* in this area will require the retention of experienced and qualified staff, computerisation of the customs administration, and refinements to the organisational structure.

Financial control: The protection of the Community's financial interests requires the development of anti-fraud services, training of specialised staff (investigators, magistrates) and the reinforcement

of systems of specific cooperation. The implementation of Community policies, especially for agriculture and the Structural Funds, requires efficient management and control systems for public expenditure, with provisions to fight fraud. Administratively it is essential to have a clear separation between external and internal control. Police and judicial authorities need to be able effectively to handle complex transnational financial crime (including fraud, corruption and money laundering) which could affect the Community's financial interests.

In Latvia the main external control body is the State Audit Office employing 160 staff. This figure may be adequate, however the effective administration of the *acquis* in this area will require substantial preparations to establish the necessary management and control mechanisms.

4.3 General Evaluation

Latvia's administrative structures will require a major, reinforced effort of reform if there is to be an adequate capacity in the medium term effectively to administer the *acquis*.

Concerning the judicial capacity effectively to apply Community law, a definite evaluation at this stage is difficult.

C. SUMMARY AND CONCLUSIONS

Latvia submitted its application for membership of the European Union on 27 October 1995. Its request is part of a historic process of ending the division of Europe and consolidating the establishment of democracy across the continent.

In accordance with the provisions of Article O of the Treaty, the Commission has, at the request of the Council, prepared an Opinion on Latvia's request for membership.

Latvia's preparation for membership is going forward notably on the basis of the **Free Trade Agreement** which entered into force on 1 January 1995. The European Union and Latvia signed a **Europe Agreement** on 12 June 1995. Once the ratification procedures are complete and it enters into force, it will supersede the Free Trade Agreement. Implementation of the **White Paper** of May 1995 on the Internal Market, another essential element of the pre-accession strategy, is going ahead on the basis of a National Programme adopted by the government in December 1996. The government has put in place the necessary mechanisms to coordinate its policies for European integration.

In preparing its Opinion, the Commission has applied the **criteria established at the Copenhagen European Council** of June 1993. The Conclusions of this Council stated that those candidate countries of Central and Eastern Europe who wish to do so shall become members of the Union if they meet the following conditions:

- stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
- the existence of a functioning market economy, as well as the ability to cope with competitive pressures and market forces within the Union;
- the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.

A judgment on these three groups of criteria - political, economic, and the ability to take on the *acquis* - depends also on the capacity of a country's administrative and legal systems to put into effect the principles of democracy and the market economy and to apply and enforce the *acquis* in practice.

The **method** followed in preparing these Opinions has been to analyse the situation in each candidate country, looking forward to the medium term prospects, and taking into account progress accomplished and reforms already under way. For the political criteria, the Commission has analysed the current situation, going beyond a formal account of the institutions to examine how democracy and the rule of law operate in practice.

1. Political Criteria

Latvia's political institutions function properly and in conditions of stability. They respect the limits on their competences and cooperate with each other. Elections in 1992 and 1995 were free and fair, and in each case permitted the establishment of coalition governments. The Opposition plays a normal part in the operation of the institutions. Efforts to improve the operation of the judicial system and to intensify the fight against corruption need to be sustained.

There are no major problems over respect for fundamental rights. But Latvia needs to take measures to accelerate naturalisation procedures to enable the Russian speaking non-citizens to become better integrated into Latvian society. It should also pursue its efforts to ensure equality of treatment for non-citizens and minorities, in particular for access to professions and participation in the democratic process.

Latvia demonstrates the characteristics of a democracy, with stable institutions guaranteeing the rule of law and human rights.

2. Economic Criteria

In the first three years after independence Latvia's output declined by 50%. First signs of recovery in 1994 were undermined by a banking and budget crisis the following year; but growth turned positive again in 1996 (2.8%). Since 1995 the current government has conducted a tight fiscal policy, though revenue collection is still a problem. The foreign debt ratio remains low, but Latvia has a high trade deficit. Inflation rates have declined over recent years, but still stood at 17.6% in 1996. GDP per head is about 18% of the EU average, for a population of 2.5 million. The agricultural sector employs 18% of the labour force, and accounts for 9.9% of Gross Value Added. 45% of Latvia's exports are directed to the EU, and 50% of its imports originate in the EU.

On the basis of its analysis, the Commission's judgment as to **Latvia's ability to meet the economic criteria** established at Copenhagen is as follows:

Latvia has made considerable progress in creating a **market economy**. Trade and prices have largely been liberalised. Much headway has been made in stabilising the economy. While there has been significant progress in establishing the legislative framework, effective implementation is lagging behind. Also, not all the necessary regulatory bodies are in place or working properly. Privatisation is not complete; the remaining state-owned companies are generally in poor financial condition and there is a shortage of investors.

Latvia would face serious difficulties to cope with **competitive pressure and market forces** within the Union in the medium term. The Latvian economy is relatively open and labour costs are low. However, exports consist mainly of low value-added goods. Industrial restructuring, as well as enterprise restructuring, is still needed. The banking sector is underdeveloped and weak in parts. Agriculture needs to be modernised.

3. Capacity to take on the obligations of membership

Latvia's ability to take on the *acquis* has been evaluated according to several indicators:

- the obligations set out in the Europe Agreement (even though this has not yet entered into force for Latvia), particularly those relating to the right of establishment, national treatment, free circulation of goods, intellectual property and public procurement;

- implementation of the measures set out in the White Paper as essential for establishing the single market;

- progressive transposition of the other parts of the *acquis*.

Even before the Europe Agreement has entered into force, Latvia has made significant efforts to comply with some of the obligations which will come into effect with it. Latvia is meeting its

obligations under the Free Trade Agreement, and according to the timetable for implementation set out in it. No serious bilateral problems have arisen. Latvia has also made some efforts towards compliance with the essential **single market** legislation. It has made progress in the areas of banking, industrial property rights, conformity assessment and standards and commercial law. But further work needs to be done on intellectual property rights, public markets, personal data, competition (especially the transparency of state aids), taxation and other areas.

A problem for further progress may be the weakness of the Latvian public administration, which affects not only the pace of approximation of legislation but also the quality of its implementation and enforcement.

As for **the other parts of the *acquis***, Latvia should not have significant difficulty in applying it in the medium term in the following fields: education, training and youth; research and technological development; telecommunications; audio-visual; fisheries; small and medium enterprises; trade and international economic relations; and development.

By contrast, substantial efforts will be needed in the fields of statistics and customs.

Provided that Latvia maintains current positive trends towards industrial restructuring, its **industry** should be able to cope with integration into the single market in the medium term.

For the **environment**, very substantial efforts will be needed, including massive investment and strengthening of administrative capacity to enforce legislation. Full compliance with the *acquis* could only be expected in the long term and would require increased levels of public expenditure.

Latvia has made real progress in the field of **transport**, especially air transport. Provided efforts are made in road transport, rail and sea transport, no major problems are to be expected in applying the *acquis* relating to the single market. But investment will be needed to extend the European transport network so as to ensure that the single market functions well.

It should be possible for Latvia to achieve the **employment and social affairs *acquis*** in the medium term, provided that Latvia makes substantial efforts to adapt its legislation to EU requirements in fields such as health and safety and labour law.

Latvia has opted to pursue its **regional policy** within the framework of its national development strategy. Given the necessary administrative reforms, and establishment in parallel of effective systems of financial control, Latvia should become able to use the Union's regional and structural funds for its development effectively.

The **agriculture** sector needs restructuring, and only a limited number of the mechanisms of the common agricultural policy currently exist. A substantial and sustained effort will be required to prepare for accession in the medium term.

In the **energy** field, Latvia has no nuclear power programme, and no difficulties are foreseen for Latvian compliance with Euratom provisions. But work will be needed to prepare to meet the *acquis* in the fields of energy pricing, access to networks, energy efficiency and environmental norms.

On the basis of the analysis of Latvia's capacity to apply the *acquis*, it is not yet possible to be sure when it could become able to take and implement the measures necessary to remove the controls at **borders** between Latvia and member states of the Union.

Latvia's participation in the third stage of **economic and monetary union**, which implies coordination of economic policy and complete liberalisation of capital movements, still poses problems in the medium term. It is premature to judge whether Latvia will be in a position, by the time of its accession, to participate in the Euro area. That will depend on how far the success of its structural transformation enables it to achieve and sustain permanently the convergence criteria. These are, however, not a condition for membership.

In the field of **justice and home affairs**, Latvia is starting from a low base and faces considerable difficulties in preparing itself. A major and sustained effort will be needed if Latvia is to be ready to meet the *acquis* in the medium term.

Latvia should be able to fulfil its obligations in respect of the **common foreign and security policy**.

In addition, Latvia has no major territorial disputes with any Member State or candidate country. Latvia has set development of good relations with Russia as a major priority of its foreign policy, and has achieved important progress.

4. Administrative and legal capacity

For Latvia to have in the medium term the administrative structures necessary for the essential work of applying and enforcing the *acquis* effectively, there will need to be a major, reinforced effort of reform.

The same applies to Latvia's judicial system, which has an equally important role to play.

CONCLUSION

In the light of these considerations, the Commission concludes that:

- Latvia presents the characteristics of a democracy, with stable institutions, guaranteeing the rule of law, human rights and respect for and protection of minorities. But measures need to be taken to accelerate the rate of naturalisation of Russian-speaking non-citizens to enable them to become better integrated into Latvian society;

- Latvia has made considerable progress in the creation of a market economy, but it would face serious difficulties to cope with competitive pressure and market forces within the Union in the medium term;

- Latvia has made some progress in transposing and implementing the *acquis* relating particularly to the single market. With considerable further effort it should become able to participate fully in the single market in the medium term. Particular efforts, including investment, will be needed to apply the *acquis* fully in sectors such as environment and agriculture. Strengthening of the administrative structure is indispensable if Latvia is to have the structures to apply and enforce the *acquis* effectively.

In the light of these considerations, the Commission considers that negotiations for accession to the European Union should be opened with Latvia as soon as it has made sufficient progress in satisfying the conditions of membership defined by the European Council in Copenhagen.

The reinforced pre-accession strategy will help Latvia to prepare itself better to meet the obligations of membership, and to take action to improve the shortcomings identified in this Opinion. The Commission will present a report no later than the end of 1998 on the progress Latvia has achieved.

ANNEX

COMPOSITION OF PARLIAMENT

RESULTS OF LAST GENERAL ELECTIONS (1995)

<u>Political parties</u>	<u>Seats</u>
Democratic Party Saimnieks	20
Latvian Way	17
Peoples' Movement for Latvia	10
Fatherland and Freedom	14
Conservative Party	8
Farmers' Union	8
Harmony Party	4
Unity Party	8
Socialist Party	5
Nation and Justice Party	6

SINGLE MARKET: WHITE PAPER MEASURES

This table is based on information provided by the Latvian authorities and confirmed by them as correct as at the end of June 1997. It does not indicate the Commission's agreement with their analysis. The table includes directives and regulations cited in the White Paper which total 899. These have been listed in accordance with the categorization used in the White Paper and in relation to the policy areas covered. The table shows the number of measures for which the Latvian authorities have notified the existence of adopted legislation having some degree of compatibility with the corresponding White Paper measures.

White Paper chapters		Directives		Regulations		Total
		Stage I	Stage II/III	Stage I	Stage II/III	
1.Free Movement of Capital	Latvia	2	1	0	0	3
	Number of White Paper measures	3	1	0	0	4
2.FM and Safety of Industrial Products	Latvia	36	8	1	0	45
	Number of White Paper measures	56	104	4	1	165
3.Competition	Latvia	3	0	1	0	4
	Number of White Paper measures	3	0	1	0	4
4.Social policy and action	Latvia	3	12	0	0	15
	Number of White Paper measures	12	15	0	2	29
5.Agriculture	Latvia	26	13	7	0	46
	Number of White Paper measures	93	46	62	2	203
6.Transport	Latvia	12	6	2	4	24
	Number of White Paper measures	19	15	8	13	55
7.Audiovisual	Latvia	1	0	0	0	1
	Number of White Paper measures	1	0	0	0	1
8.Environment	Latvia	4	0	2	0	6
	Number of White Paper measures	31	7	7	0	45
9.Telecommunication	Latvia	5	1	0	0	6
	Number of White Paper measures	9	7	0	0	16
10.Direct Taxation	Latvia	0	0	0	0	0
	Number of White Paper measures	2	2	0	0	4
11.Free movement of goods	Latvia	0	0	0	0	0
	Number of White Paper measures	0	0	0	0	0
12.Public Procurement	Latvia	5	2	0	0	7
	Number of White Paper measures	5	1	0	0	6
13.Financial services	Latvia	9	5	0	0	14
	Number of White Paper measures	13	8	0	0	21
14.Protection of personal data	Latvia	0	0	0	0	0
	Number of White Paper measures	0	2	0	0	2
15.Company Law	Latvia	2	3	0	0	5
	Number of White Paper measures	2	3	0	1	6
16.Accountancy	Latvia	2	1	0	0	3
	Number of White Paper measures	3	2	0	0	5
17.Civil law	Latvia	1	0	0	0	1
	Number of White Paper measures	1	1	0	0	2
18.Mutual rec. of prof. Qual.	Latvia	2	12	0	0	14
	Number of White Paper measures	2	16	0	0	18
19.Intellectual property	Latvia	4	1	0	1	6
	Number of White Paper measures	5	3	0	3	11
20.Energy	Latvia	4	0	0	0	4
	Number of White Paper measures	10	2	3	0	15
21.Customs law	Latvia	0	0	13	3	16
	Number of White Paper measures	2	1	14	184	201
22.Indirect Taxation	Latvia	12	15	0	0	27
	Number of White Paper measures	15	54	0	6	75
23.Consumer Protection	Latvia	6	0	0	0	6
	Number of White Paper measures	8	3	0	0	11
Total	Latvia	139	80	26	8	253
	Number of White Paper measures	295	293	99	212	899

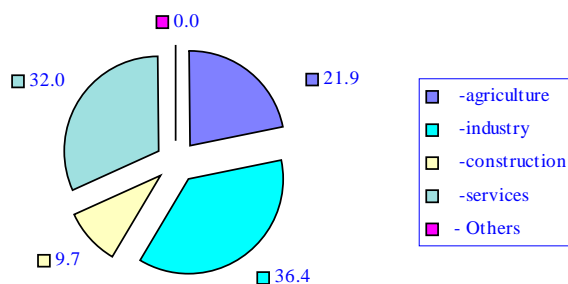
STATISTICAL DATA

If not explicitly stated otherwise, data contained in this annex are collected from „ **Central Statistical Bureau of Latvia** (LATVIJAS REPUBLIKAS VALSTS STATISTIKAS KOMITEJA)“ with whom Eurostat and Member States’ statistical offices are co-operating since several years in the framework of the Phare programme. Regular data collection and dissemination are part of this co-operation process with the aim to enable the application of EU laws and practices in statistics. Data correspond to the information available as of May 1997. The data presented below have been compiled as far as possible using EU definitions and standards which in some cases differ from national practices. This may occasionally give rise to differences between the data presented here and those shown elsewhere in the opinion, which are generally based on the individual applicant countries’ updated replies to the questionnaire sent to them in April 1996. The exact compatibility with EU standards on statistics and thus the comparability with EU figures can still not be guaranteed, particularly those statistics that have not been supplied through Eurostat but have been delivered directly by the countries concerned. Wherever available, methodological notes are given describing content and particularities of statistical data presented in this annex. Data correspond to the information available as of May 1997.

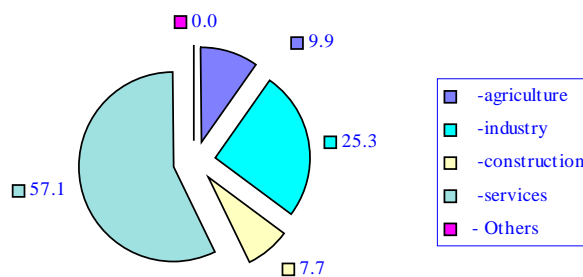
BASIC DATA

	1990	1993	1994	1995	1996
Total Area	1000 hectares				
		6458.9	6458.9	6458.9	6458.9
Population (end of the period)	in 1000				
- Total		2565.8	2529.5	2501.7	2479.9
- Females		1375.1	1357.5	1343.2	1332.2
- Males		1190.7	1172.0	1158.5	1147.7
Population density	per 1 km2				
	41.3			38.7	38.4
Urban Population	in % of total population				
	69.2			69.0	68.9
Deaths rate	per1000 of population				
		15.2	16.4	15.5	13.8
Births rate		10.3	9.5	8.6	7.9
Income and GDP per capita	European Currency Unit				
-Average monthly wage and salary per employee				130	
-GDP per capita				1366	
Structure of production: share of branch GVA	in % of Total Gross Value Added				
-agriculture	21.9			9.9	
-industry	36.4			25.3	
-construction	9.7			7.7	
-services	32.0			57.1	

share of branch GVA in 1990



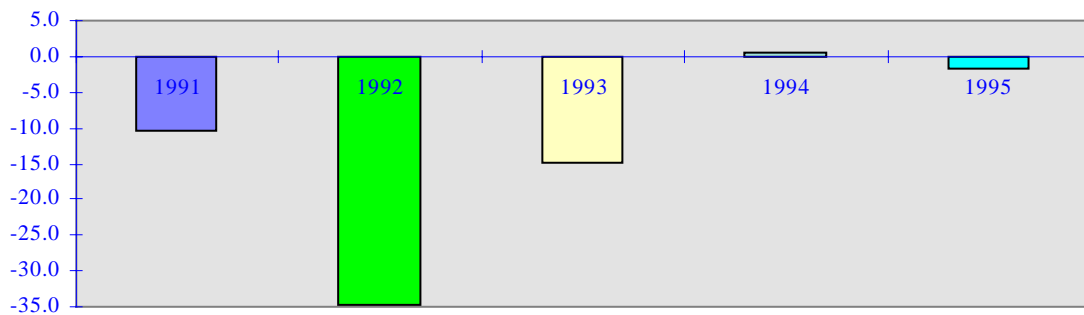
share of branch GVA in 1995



NATIONAL ACCOUNTS

	1990	1991	1992	1993	1994	1995
	in Millions of National Currency					
Gross Domestic Product (Current Prices)	62.44	143.3	1004.6	1467.0	2042.6	2360.7
	in Billions of ECU					
Gross Domestic Product (Current Prices)			1.1	1.9	3.1	3.4
	in Purchasing Power Standard per capita					
Gross Domestic Product				2867.3	3044.5	3159.4
	% change over the previous year					
Gross Domestic Product		-10.4	-34.9	-14.9	0.6	-1.6
Final consumption expenditure		-23.1	-35.0	-4.9	2.0	3.7
-of households and NPISH		-26.0	-43.3	-7.4	3.2	3.9
-of general government		-4.9	5.6	1.6	-0.9	3.1
Gross fixed capital formation		-63.9	-28.7	-15.8	0.8	12.6
Exports of goods and services		-32.2	14.9	-22.4	-8.4	-3.4
Imports of goods and services		-43.9	8.0	-39.8	-0.7	-2.8
	in % of Gross Domestic Product					
Final consumption expenditure	61.2	56.5	51.9	74.6	78.8	80.1
-of households and NPISH	52.7	46.2	39.4	52.5	58.7	59.4
-of general government	8.6	10.3	12.5	22.1	20.1	20.7
Gross fixed capital formation	23.0	6.2	11.2	13.8	14.9	16.6
Exports of goods and services	47.7	35.2	79.9	73.2	46.5	47.1
Imports of goods and services	49.0	25.5	73.1	57.0	44.4	49.1

GDP (% Change over the previous year)



MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996
Inflation rate	percentage change over the previous year						
	10.5	172.2	951.2	109.2	35.9	25	17.6
	previous year = 100						
Industrial production volume indices				67.9	90.1	96.3	101.4
Gross agricultural production volume indices				78	80	94	90
Unemployment rate (ILO methodology)	in % labour force						
- Total						18.9	18.3
- less than 25 years						30.1	29
- 25 years and more						17	16.6
	in Billions of USD						
Gross Foreign debt			0.057	0.224	0.386	0.4034	0.4088
Balance of payments	in millions of USD						
-Exports of goods			800	1054	1022	1368	1502
-Imports of goods			-840	-1051	-1322	-1947	-2429
-Trade balance			-40	3	-300	-579	-927
-Services, net			134	329	361	474	344
-Income, net			1	7	9	19	1
-Current account balance			191	417	201	-19	-495
-Capital and fin. acc.(excl. reserves)			-75	140	410	692	325
-Reserve assets			-73	-371	-103	35	-186

Inflation rate: Percentage change of yearly average over the previous year - all items index (data are based on national CPIs which are not strictly comparable)

Unemployment rate (by ILO methodology): - Percentage of the unemployed in labor force. This rate is derived from LFSS (Labor Force Survey) observing the following ILO definitions and recommendations:

Labor force employed and unemployed persons in the sense of the ILO definitions stated below.

The employed all persons aged 15+, who during the reference period worked at least one hour for wage or salary or other remuneration as employees, entrepreneurs, members of cooperatives or contributing family workers. Members of armed forces and women on child-care leave are included.

The unemployed all persons aged 15+, who concurrently meet all three conditions of the ILO definition for being classified as the unemployed: (i) have no work, (ii) are actively seeking a job and (iii) are ready to take up a job within a fortnight. Data for 1995 and 1996 refer to November 1995 and November 1996.

Data from November 1995 LFSS monitors the population aged 15-69. Data from May and November 1996 LFSS monitors the population aged 15 years and over. LFSS excludes persons on compulsory military service and persons living in nonprivate households. Employees on maternity leave and child care until 3 months are included.

Gross foreign debt: Debt is extracted from the OECD's External Debt Statistics.

Balance of payments: Data is derived from IMF database, their comparability with respective EU statistics can not be guaranteed, but balance of payments is compiled mainly in accordance to IMF standards. 1996 figures are preliminary. Balance in trade of goods in accordance with balance of payments principles. Exports and imports are both in f.o.b. values. Net income includes direct, portfolio and other investment income, compensation of employees. Current account balance by definition of IMF 5th Manual, capital transfers are excluded. Reserve assets: it means changes in reserve assets during the year; (+) signifies an increase, (-) a decrease in reserve assets.

FOREIGN TRADE

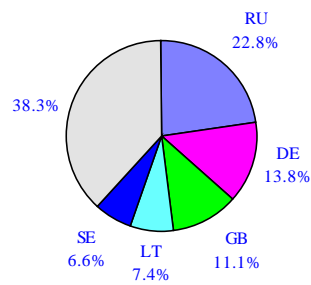
	1993	1994	1995	1996
Imports and exports (current prices)	in millions of USD			
- Imports	947	1240.4	1817.4	2320
- Exports	1000.9	988.2	1303.8	1443.2
- Balance of trade	53.9	-252.1	-513.6	-876.6
External trade volume indices	previous year = 100			
- Imports				
- Exports		67.8	113.7	108
Structure of Import by SITC (current prices)	in % of total Import			
- (0+1) food and live animals, beverage and tobacco	5.8	9.9	9.7	11.9
- 2 crude materials, inedible	1.5	1.6	2.4	2.6
- 3 mineral fuels and lubricants	45.3	29	21.2	21.6
- 4 animal and vegetable oils etc.	0.3	0.3	0.6	0.8
- 5 chemicals and related products	7.9	11.2	12.7	12.3
- 6 manufactured goods classified chiefly by material	10.1	12.8	17.1	17.6
- 7 machinery and transport equipment	19.3	22.8	25.4	22.6
- 8 miscellaneous manufactured articles	5.7	9.7	11.1	10.5
Structure of export by SITC (current prices)	in % of total Export			
- (0+1) food and live animals, beverage and tobacco	13.9	12.3	15.9	16.7
- 2 crude materials, inedible	8.7	17.8	23.8	20.1
- 3 mineral fuels and lubricants	14	1.8	1.8	2
- 4 animal and vegetable oils etc.	0.3	0.1	0.1	0.1
- 5 chemicals and related products	7.2	7.9	6.9	6.7
- 6 manufactured goods classified chiefly by material	20.4	23.9	22.9	24.4
- 7 machinery and transport equipment	20.8	20.4	16.3	14
- 8 miscellaneous manufactured articles	12	13.2	12.2	15.9
External trade price indices	previous year = 100			
- Imports				
- Exports		115.2	116.1	106.2

Imports and exports (current prices), External trade volume indices and Structure of external trade by SITC (current prices): Trade data exclude direct re-exports, trade in services and trade with customs free zones as well as licenses, know-how and patents. The data are based upon the special trade system and are regularly updated. The customs statistics is utilized for monitoring of foreign trade data. Eurostat has converted National Currencies to the US dollar by applying the International Monetary Fund annual average exchange rates.

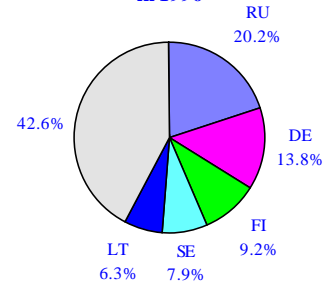
FOREIGN TRADE

	1993	1994	1995	1996
Structure of imports by main countries (current prices)	in % of total imports			
1st partner	RU 28.5	RU 23.6	RU 21.7	RU 20.2
2nd partner	DE 10	DE 13.5	DE 15.4	DE 13.8
3rd partner	LT 9.6	FI 8.5	FI 10.4	FI 9.2
4th partner	SE 5.3	SE 6.4	SE 8	SE 7.9
5th partner	FI 4.2	LT 5.9	LT 5.5	LT 6.3
others	42.4	42.1	39	42.6
Structure of exports by main countries (current prices)	in % of total exports			
1st partner	RU 29.6	RU 28.1	RU 25.3	RU 22.8
2nd partner	NL 8.2	DE 10.5	DE 13.6	DE 13.8
3rd partner	DE 6.6	GB 9.7	SE 9.3	GB 11.1
4th partner	SE 6.5	SE 6.9	GB 9.1	LT 7.4
5th partner	UA 5.9	UA 5.9	LT 5.5	SE 6.6
others	43.2	38.9	37.2	38.3

Structure of export by main partners
in 1996



Structure of import by main partners
in 1996



DE	Germany	NL	Netherlands
FI	Finland	RU	Russian Federation
GB	United Kingdom	SE	Sweden
LT	Lithuania	UA	Ukraine

SOCIAL INDICATORS

	1991	1992	1993	1994	1995
Population on 1 January	thousand				
	2667.87	2656.96	2606.18	2565.8	2529.5
Proportion of population by age (1 January 1995)	in % of total population				
y0_14					20.7
y15_24					13.5
y25_44					28.4
y45_64					24.1
y65_max					13.4
Live births	total number				
	34633	31569	26759	24256	
Deaths	34749	35420	39197	41757	
Infant deaths	per 1000 of population				
- Less than 1 year	545	557	434	381	
- Still birth	315	340	276	244	
Marriages	22337	18906	14595	11572	
Divorces	11070	14553	10278	8416	
Crude marriage rate	8.39	7.18	5.64	4.5	4.4
Crude divorce rate	4.16	5.53	3.97	3.3	3.1
Natural growth rate	-0.04	-1.46	-4.81	-6.8	
Net migration rate	-4.05	-17.6	-10.7	-7.38	
Total population growth rate	-4.1	-19.1	-15.5	-14.25	
Total fertility rate	1.86	1.73	1.51	1.39	
Infant mortality rate	15.74	17.64	15.9	15.5	18.5
Late foetal mortality rate	9.01	10.66	10.21	9.96	
Life expectancy	at birth				
- Males					60.8
- Females					73.1
Life expectancy	at 65 years				
- Males					11.7
- Females					15.8

LABOUR MARKET

	1993	1994	1995	1996
Economic Activity Rate (ILO methodology)	in % of population age +15			
			67.6	59.8
Average employment	in thousand			
	792.1	694.9	687.3	693.1
Unemployment rate (ILO methodology)	in % of labour force			
- Total			18.9	18.3
- less than 25 years			30.1	29
- 25 years and more			17	16.6
Registered unemployment (end of period)	in % of economically active population			
	5.8	6.5	6.6	7.2

	1993	1994	1995	1996
Average paid employment indices by NACE classes	previous year = 100			
- Agriculture, hunting, forestry and fishing	62.7	53.7	81.8	82.4
- Mining and quarrying	74	100.9	90.7	101.1
- Manufacturing	71.5	84.3	93.8	99.1
- Production and distribution of electricity, gas and water	115	111.7	102.1	105.5
- Construction	63	88.6	95.9	92.9
- Transport, storage and communication	86.2	92.7	96.1	100.4
Monthly wages and salaries indices				
- real	105	112	99.6	93.8
- nominal	219.7	152.2	124.5	110.3

Economic activity rate (ILO Methodology) - percentage of labor force in the total population aged 15+. This rate is derived of LFSS (Labor Force Survey) observing the following ILO definitions and recommendations:

Labor force employed and unemployed persons in the sense of the ILO definitions stated below.

The employed all persons aged 15+, who during the reference period worked at least one hour for wage or salary or other remuneration as employees, entrepreneurs, members of cooperatives or contributing family workers. Members of armed forces and women on child-care leave are included.

The unemployed all persons aged 15+, who concurrently meet all three conditions of the ILO definition for being classified as the unemployed: (i) have no work, (ii) are actively seeking a job and (iii) are ready to take up a job within a fortnight.

Data for 1995 and 1996 refer to November 1995 and November 1996.

Unemployment rate (by ILO methodology): - Percentage of the unemployed in labor force. This rate is derived from LFSS (Labor Force Survey) observing the ILO definitions and recommendations (see ILO definitions above).

Data from November 1995 LFSS monitors the population aged 15-69. Data from May and November 1996 LFSS monitors the population aged 15 years and over. LFSS excludes persons on compulsory military service and persons living in nonprivate households. Employees on maternity leave and child care until 3 months are included.

Average employment and Average paid employment indices by NACE classes: The data for entrepreneurial sphere cover in enterprises and other organisations under all kinds of ownership. The data cover all budgetary organisations. Persons in compulsory military service and employees on childcare leaves are excluded.

Registered unemployment (end of period): Registered unemployment in per cent - percentage of unemployed registered in civil economically active population, based on Labour force sample survey (LFSS). Registered unemployment data are based on the monthly data from State Employment Board.

Monthly wages and salaries indices: The data for entrepreneurial sphere cover in enterprises and other organisations under all kinds of ownership. The data cover all budgetary organisations. Persons in compulsory military service and employees on childcare leaves are excluded. Index numbers of monthly *real* wages and salaries is derived from index numbers of *gross* nominal wages and salaries divided by consumer price index numbers.

PUBLIC FINANCE

	1990	1991	1992	1993	1994	1995
Government budget	in millions of national currency					
-Consolidated central government revenue					523.62	686.5
-Grants					2.66	
-Consolidated central government expenditure					564.17	756.39
-Consolidated general government expenditure					742.33	975.51
-Consolidated central government deficit/surplus					-37.89	-69.89
-General government deficit/surplus					-92.83	-121.37
Government budget	in % of Gross Domestic Product					
-Consolidated central government expenditure					27.6	32.0
-Consolidated general government expenditure					36.3	41.3
-Consolidated central government deficit/surplus					-1.9	-3.0
-General government deficit/surplus					-4.5	-5.1

Government budget: These data relate to central and general government as published in the IMF's *Government Finance Statistics Yearbook (1996) (GFSY)*; included also is the country's presentation in the *GFSY*.

Because the *GFSY* does not present statistics for general government, but for individual levels of government separately, the consolidated series presented here were obtained from central and local government data and adjusted in consolidation for the identified intergovernmental transfers.

Even though the statistics cover the central and local government published in *GFSY*, the coverage may not be exhaustive if some central or local government units are not included in that coverage. A measure of the exhaustiveness of the coverage can be obtained by comparing in the *GFSY* the note on the coverage of data for individual countries with the list of central and local government units provided.

It should be noted that the deficit/surplus used here is equal to revenue and grants minus expenditure, and does not take lending minus repayments into account (see further below).

The netting of inter-government transfers carried-out in the attached tables is limited to the current and capital transfers consisting of the identified grants and current and capital subsidies between the levels of government. Other types of transactions occurring between government levels, such as the payments of taxes and employers' social security contributions, and the reciprocal purchases of goods and services are not normally classified as inter-governmental transfers have not been eliminated in the consolidation process. Finally, whether the absence of data for current and capital transfers should be attributed to the absence of transfer or to lack of data is unclear; in all cases absence of information on transfers have been deemed to represent zero-transfers.

a. Government expenditure consists of general government cash expenditures on current and capital goods and services, interest payments and current and capital transfers but excludes non-cash transactions.

b. Deficit/surplus equals cash revenue and cash grants minus cash expenditure. This measure of the deficit/surplus differs from that used in GFS which equals cash revenue and cash grants, minus cash expenditure, minus net lending. This exclusion of net lending (consisting, in the *GFS* methodology, of operations in financial assets and liabilities carried out for specific policy purposes, rather than for liquidity purposes) brings the measure of the deficit/surplus presented here closer to the national accounts concept of net borrowing/net lending. Also, as a result of this exclusion, receipts from privatisation (classified as repayments in the *GFS* methodology) do not enter in the determination of the deficit/surplus presented in the attached tables (and therefore do not reduce the deficit).

FINANCIAL SECTOR

	1990	1991	1992	1993	1994	1995	1996
Monetary aggregates	Billions (10 ⁹) of US Dollars						
- Monetary aggregate M1				0.35	0.62	0.62	0.73
- Quasi money				0.43	0.63	0.35	0.40
Total reserves (gold excluded, end of period)	Millions (10 ⁶) of US Dollars						
				431.55	545.18	505.7	654.06
Average short term interest rates	% per annum						
- lending rate				86.36	55.86	34.56	25.78
- deposit rate				34.78	31.68	14.79	11.71
Official discount rate (end of period)				27	25	24	9.5
USD exchange rates	1 USD = ...LVL						
Average of period			0.736	0.675	0.56	0.528	0.551
End of period			0.835	0.595	0.548	0.537	0.556
ECU exchange rates	1 ECU = ...LVL						
Average of period			0.955	0.790	0.666	0.691	0.706
End of period			1.011	0.664	0.674	0.706	0.697

Monetary aggregates (end of period): Money (M1) Includes demand deposits and currency outside banks. *Quasi money* Include time, savings and foreign currency deposits. Eurostat has converted National Currencies to the US dollar by applying the International Monetary Fund annual end of period exchange rates.

Average short term interest rates: Data are extracted from the IMF's monthly International Financial Statistics (IFS). Average short-term lending and deposit rates relate to period averages. *Lending rates* generally consist of the average interest rate charged on loans granted by reporting banks. *Deposit rates* relate to average demand and time deposit rates or average time deposit rates. These rates may not be strictly comparable across countries to the extent the representative value of the reporting banks and the weighting schemes vary.

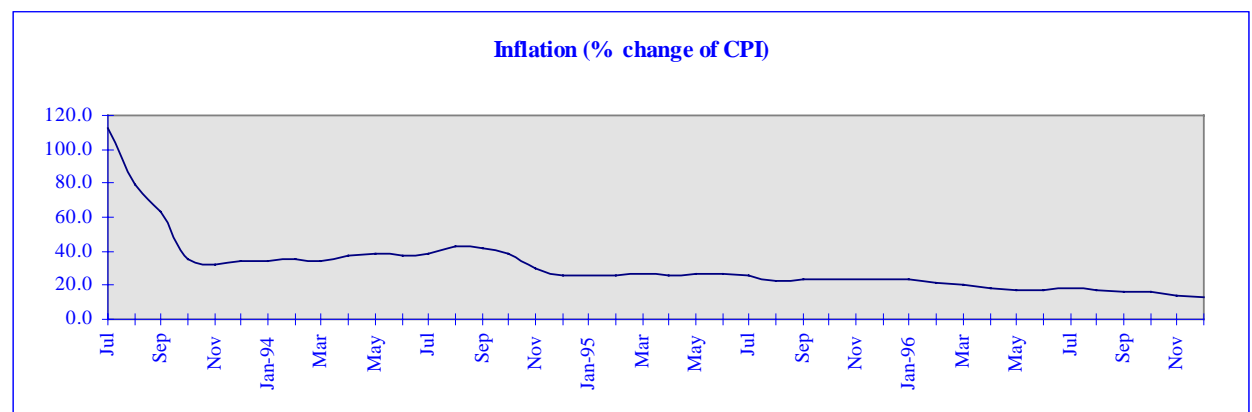
Total reserves (gold excluded, end of period): The statistics on official foreign reserves are extracted from the IMF's monthly International Financial Statistics (IFS). Total reserves (gold excluded) are defined as the sum of central bank holdings of foreign currencies and other (gross) claims on non-residents; this definition excludes claims on residents denominated in foreign currency. According to the definition; official foreign reserves are calculated at market exchange rates and prices in force at the end of the period under consideration. Total reserves (gold excluded) published in IFS may differ from the figures published by the national authorities. Some factors contributing to possible differences are the valuation of the reserve position in the Fund, and a different treatment of claims in non-convertible currencies.

USD exchange rates: International Monetary Fund exchange rates as present in the publication: "Statistiques Financieres Internationales".

INFLATION (12 months changes)

Percentage change of the CPIs with the current month compared with the corresponding month of the previous year (t/t-12)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1993							112.0	79.1	63.4	35.5	31.7	34.8
1994	34.3	35.0	34.2	37.2	38.1	37.7	38.1	43.1	41.7	38.2	29.5	26.2
1995	26.0	25.6	26.6	25.7	27.2	26.5	25.3	22.8	23.6	24.1	23.9	23.2
1996	23.2	21.4	20.2	18.6	17.4	17.6	17.7	17.4	16.1	15.7	14.4	13.2



Inflation (12 months changes): Inflation rates (12 months changes) are percentage changes of the CPIs with the current month compared with the corresponding month of the previous year. Inflation rates are based on national CPIs which are not strictly comparable between candidate countries or with those based on EU HICPs (different methods, concepts, practices in the calculation of CPIs).

INDUSTRY

	1993	1994	1995	1996
Structure of GDP by economic activities (NACE, current prices)	in % of Gross Domestic Product			
- Mining and quarrying	0.2	0.2	0.2	0.2
- Manufacturing	23.1	19.9	22.4	22
- Production and distribution of electricity, gas and water	7.5	5.2	5.5	5.6
Industrial production volume indices by NACE classes	previous year = 100			
- Total	67.9	90.1	96.3	101.4
- Mining and quarrying	67.1	122.5	83.2	153.6
- Manufacturing	65.1	88	95.5	100.8
- Production and distribution of electricity, gas and water	80.2	98	99.8	102.2

Industrial production volume indices by NACE classes: Industrial production covers mining and quarrying, manufacturing and electricity, gas and water supply (according to the NACE Classification Sections C,D,E).

INFRASTRUCTURE

	1985	1990	1995	1996
Railway network	in Km per 1000 Km2			
	36.9	37.1	37.4	37.4
Length of motorways	Kilometre			
Number of inhabitants per passenger car	inhabitants			
	12	9	8	7

AGRICULTURE

	1992	1993	1994	1995	1996
Land area by land-use categories	in 1000 Hectares				
- total		6458.9	6458.9	6458.9	6458.9
- agricultural land	2567.8	2541.6	2537.8	2540.3	2541.2
- forest		2829.7	2839.2	2869.7	2881.2
- arable land	1689.1	1691.9	1710.5	1710.1	1712.6
- permanent meadows and pastures	843.4	825.1	803.4	800.5	798.1
Agricultural land by legal status	in % of agricultural land				
- state enterprise		2.6	2	1.9	1.3
- Cooperatives		64.6	30.8	16.9	11.4
- others		32.8	67.2	81.2	87.3

	1992	1993	1994	1995	1996
Share of GDP	in % of Gross Domestic Product				
- Agriculture, hunting, forestry and fishing (Nace A+B)		11.8	9.5	9.9	
	Previous year = 100				
Gross agricultural production volume indices		78	80	94	90
Main crops by area	in 1000 Hectares				
- Cereals	696.7	693.6	486.3	408.4	446.2
- of which: wheat	128.6	169.1	94.6	109.6	149.2
- Potatoes	97	88	80	75	79
- Sugar beet	25	12	12	10	10
- Fodder beet	37	30	26	20	17
Main crops by yield	in 100 kg/Hectares				
- Cereals	16.4	17.7	18.4	16.9	21.5
- of which: wheat	25.9	20.0	21.1	22.2	24.0
- Potatoes	120.5	145.0	130.0	114.7	137.5
- Sugar beet	186.5	246.3	190.2	263.2	257.8
- Fodder beet	247.0	290.2	262.2	218.5	230.7

	1992	1993	1994	1995	1996
Sales or procurement of animal for slaughter	in 1000 tons of live weight				
- pigs					
- cattle					
- poultry					
Livestock breeding intensity (end of period)	heads per 1000 Ha of agricultural land				
- cattle		267	217	211	200
- of which: cows		138	123	115	109
- sheep		45	34	28	22
	heads per 1000 Ha of arable land				
- pigs		285.4	292.3	323.8	268.6