



FICIL  
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TOMORROW IS  
THE CONSEQUENCE  
OF NOW

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## **FICIL Position Paper on Macroeconomic Policy Issues**

In contrast with the talk of increasing risks of recession in many parts of the world, affected by weak economic data and falling risk susceptibility, Latvia's GDP increased by 4.8% in 2018. This impressive increase is mainly due to the rapid breakthrough in the construction sector. There are also significant increases in many service sectors: of particular note is the performance of the information technology and communication sector. External environment conditions continue to weaken, which has led many countries to lower their growth forecasts. Following global and regional trends, Latvia's economic growth rate is also slowing down. However, although risks and uncertainty have increased, Latvia's economic prospects remain positive. In these circumstances, household consumption will be one of the drivers of economic activity.

FICIL appreciates the reform undertaken by the previous government led by M. Kučinskis and hopes that the Cabinet established by K. Kariņš will also continue to have a close dialogue with FICIL. The weakening of economic prospects means that the possibilities for continuing and launching reforms in areas of economic importance should be assessed more thoroughly. FICIL calls for decisive action to address critical issues, particularly in **restoring the country's reputation**.

**The next EU fund financing period must be prepared for in good time.** In the next two years, EU funds will be a stabilising factor in the economy of Latvia and will continue to fuel the construction sector and boost investment. The ability of the construction industry to increase capacity and efficiency in order to maintain growth is a pressing issue. Solutions are also needed for the funding gap next year in road construction. Given the uncertainty about the availability and conditions of EU funding beyond 2020, an action plan needs to be drawn up in good time to allow better adaptation to the new circumstances. As experience shows, the success of a forward-looking policy is to mitigate the impacts of economic cycles. **It is very important, therefore, to finally start developing a State budget with a surplus, to allow amortisation in case of a downturn.**

**Public administration reforms must be continued.** The Council considers that work on the review of the size of public administration functions, expenditure and the number of employees should be activated. FICIL supports the quick and effective implementation of the 2020 public administration reform plan.

**The amount of funding for research and development must be increased.** Although the funding available in many fields has grown, there is obvious and considerable political

stagnation in the field of research and development, as a result of which the situation continues to worsen. The funds allocated for research and development in 2015 were 0.63% of the GDP, but in 2016 this had dropped to 0.44% of the GDP. It must be noted that the government's set target amount is 1.5%. FICIL calls for this target to be set as one of the priorities and to aim towards achieving the set amount, as investment into research and development is an essential factor in determining the level of competitiveness of any country's economy

**Emphasis on exports must be maintained.** The favourable economic climate has allowed a growth in export amounts, and its role in the development of the economy continues to grow. Initiatives for supporting exports, which have reaped returns, should therefore be maintained and, where possible, this support should be increased. A lack of ambition and information continues to pose a great challenge among small- and medium-sized businesses, who continue to refrain from exporting, due to a lack of knowledge and determination.

**There are considerable achievements in the struggle with the shadow economy.** Although it has shrunk in the post-crisis period, the shadow economy in Latvia is still the highest in the Baltics, which is a major obstacle to both successful economic development and budget revenues. Considerable improvements can be seen in the daily work and attitude of the SRS. The initiated proactive policy towards combating the shadow economy should be continued, as it creates a more favourable environment both for local and foreign businesses and helps to improve investor opinions about the State. More active progress towards the development and wider use of an e-environment and services is a significant instrument for curbing the shadow economy, as well as raising the effectiveness of State institutions

**The MPC issue is reaching a close.** Following prolonged hesitation, progress in the review of the mandatory procurement components (MPC) system is noticeable. This has allowed a reduction of MPC payments for many and especially for large manufacturing companies, and increased their competitiveness. However, the critical matters of the system have still not been resolved. Subsequent improvements are especially essential, in order to ensure a balance between the sustainability of the system and competitiveness of manufacturing companies.

**The demographic situation must also furthermore be among one of the main government priorities.** The quality of life of residents is gradually improving however, a decrease in the population numbers continues. FICIL appreciates efforts made to promote the birth rate and reduce the risk of poverty for families with children. The commenced work must continue and the incentives for these aims boosted, as well as being developed more purposefully.

**FICIL emphasises the importance of the next phase of implementing the administrative territorial reform.** The current territorial division does not comply with the aim of Latvia's economic sustainability. Such conditions prevent the creation of a sufficient basis for regional development, and halt the improvement of welfare for regional residents. A greater concentration of administrative, financial and human resources will improve opportunities for entrepreneurship and create a more attractive environment for investments. Improvement of economic conditions in the regions will allow a break in migration trends. With the help of an investment policy, an optimal infrastructure for regional development should be ensured, including a prime network of educational establishments, which often means reducing the number of infrastructure units and introducing the type of funding mechanisms which promote innovation. Special emphasis must be placed on the creation and development of digital services.

**The greatest challenge – the labour market.** The number of residents of working age continues to drop which reduces the number of available employees and slows growth. The situation is becoming more acute, and pressure is mounting on payments and inflation. A great deal of financing is being invested in the training of the unemployed, and the effectiveness and relevance of existing programmes to the current situation in the labour market should be reassessed, if necessary making changes. Special attention should be paid to motivating the long-term unemployed to acquire the qualifications required by the market. Conditions for the older generations should also be developed, especially to retain and return senior employees to the labour market. The high unemployment level in the regions indicates structural shortcomings. A lack of workplaces in the regions is a catalyst for the emigration of residents and the permanence of regional inequalities. The mobility of residents should be endorsed, as well as the improvement of knowledge and skills of unemployed residents. One of the solutions for the lack of a workforce is immigration. A weighted immigration policy is needed, to allow achievement of the main aim – to create services and goods with a high added value. **FICIL looks forward to a constructive dialogue with the government on this issue.**

**Education.** Reforms of the education system, particularly in the fields of higher and vocational education, should be continued consistently. By gaining confidence that the quality of specialists prepared by Latvian higher and vocational education institutions is increasing, investors will be able to take more positive investment decisions, productivity should increase more rapidly and the challenges of a workforce shortage diminished.

**Through reform to a flawless reputation.** Growth in the coming years will bring the residents of Latvia closer to the quality of life standards of the EU. However, long-term improvements will be changeable. To speed up the positive changes, the government must be able to improve the State's reputation through purposeful reforms. The aim to create a Latvia with an environment appealing to investors with the potential for stable growth remains unchanged.

**One of the most urgent tasks is to ensure the implementation of the recommendations of Moneyval,** which would eliminate risks to the stability of Latvia's financial system, for it to comply with internationally recognised standards for the prevention of money laundering and financing of terrorism. By the end of 2019, Latvia needs to make significant improvements to these indicators. The failure to fulfil this obligation threatens to increase the cost of funding available to Latvia's entrepreneurs and residents and complicate international payment transactions, which will negatively impact upon the settlements of Latvian businesses and worsen the Latvian investment environment, which will result in a drop-in growth rates. All necessary steps must be taken to avoid this situation.

**Development of the capital market.** When assessing the development of Latvia's capital market and comparing it with other countries of the European Economic Area, it can be concluded that Latvia has the lowest market capitalisation, i.e. the total market value of publicly listed companies, against the GDP. This indicates an insufficient level of capital market development. A developed capital market is an essential condition for sustainable economic growth. Capital markets ensure efficient use of resources and matching of cash flows. By attracting investments and modernising production or services, it is possible to improve the efficiency and productivity of businesses, which is currently 67% of the EU average, according to the European Commission. As a result, both the national economy and market participants benefit.