



# European Construction Sector Observatory

Country profile **Latvia**

December 2020



## In a nutshell

In 2019, Latvia's GDP amounted to EUR 27.5 billion, exhibiting a 2.2% growth over the previous year. This is lower than the growth experienced in 2018 (4.3%), which is explained by a slowdown in investment and a fall in exports led by a deteriorating external environment.

The **number of enterprises** in the Latvian broad construction sector increased by 43.2% between 2010 and 2019, totalling 30,740. This growth was mainly driven by the increase in the number of enterprises in the narrow construction (+90.7%), the architectural and engineering activities (+85.2%), the manufacturing (+42.8%), and the real estate activities (+11.0%) sub-sectors over the same reference period.


Number of enterprises in the narrow construction sub-sector between 2015 and 2019  **90.7%**

In parallel, the **volume index of production** in the broad construction sector recorded an increase of 24.1% during 2015-2019, mainly driven by a 47.2% increase in the construction of buildings and an 8.8% growth in the construction of civil engineering, over the same period.

Volume index of production in the construction of buildings between 2015 and 2019  **47.2%**

Similarly, the **turnover** of the broad construction sector grew by 54.4% between 2010 and 2017, reaching EUR 7.3 billion. It further increased to EUR 9.3 billion in 2019, marking a 95.9% acceleration since 2010. This overall increase was mainly driven by the turnover growth in the

manufacturing (+131.9%), narrow construction (+104.3%), the architectural and engineering activities (+60.1%), and the real estate activities (+46.6%) sub-sectors over the 2010-2019 period.

Total turnover of the manufacturing sub-sector between 2010 and 2019  **131.9%**

In parallel, the **gross operating rate** of the broad construction sector, which is used to assess the profitability of the sector, stood at 14.5% in 2017, 0.5 percentage points (pps) below the rate registered in 2010 (15.0%). The real estate activities sub-sector registered the largest profit margin in sales (31.2%) in 2017, followed by the manufacturing (15.3%), the architectural and engineering activities (14.7%), and the narrow construction (7.9%) sub-sectors.

In terms of employment, there were 145,405 **persons employed** in the Latvian broad construction sector, registering a 38.6% increase in comparison to the 2010 level (104,894 persons). This was mainly driven by the growth registered in the number of persons employed in the narrow construction sub-sector (+59.0%), followed by the architectural and engineering activities (+48.2%) and the manufacturing (+46.9%) sub-sectors, over the 2010-2019 period.

Number of persons employed in the narrow construction sub-sector between 2010 and 2019  **59.0%**

Skills shortage and mismatch are the main obstacles to the sustainable growth of the Latvian construction sector. In fact, low-skilled workers are

in lower demand and face higher unemployment. The country has adopted a construction industry development strategy for 2017-2024 to address various industry issues, such as, ensuring a qualified workforce, increasing productivity, and improving the quality of construction services. Moreover, the government has introduced preferential conditions to attract highly qualified specialists from abroad in the identified professions.

The housing market is relatively dynamic. The demand for housing has risen following the introduction of the Housing Guarantee Programme, which provides guarantees on mortgages to support the purchase and/or construction and renovation of a first home. The programme also enables families and young professionals to obtain a mortgage against lower down payment than banks would normally require.

**In June 2020, the Latvian government amended the state support program for the purchase of housing, by providing EUR 3.5 million to support large families for the purchase of housing<sup>1</sup>.**

In terms of the civil engineering market, it is important to note that investment is projected to slow down as inflows of EU funds reached their peak in 2020. Nevertheless, the construction related to the Rail *Baltica* project, which started in November 2020, is expected to boost investment in 2021.

**The outlook for the Latvian construction sector is positive in the short to medium term. Moreover, the ruling coalition's decision on the allocation of EUR 75.0 million for road infrastructure projects is expected to contribute to the growth of the construction sector.**

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## 1

## Key figures

## Construction market

The **number of enterprises** in the broad construction sector in Latvia totalled 30,740 in 2019<sup>2</sup> (Figure 1), representing a 43.2% increase compared to the 2010 level (21,464). The increase was mainly driven by the growth registered in the narrow construction and architectural and engineering activities sub-sectors, reporting an increase of 90.7% and 85.2%, respectively, between 2010 and 2019. This was followed by a 42.8% increase in the manufacturing sub-sector and an 11.0% growth in the real estate activities sub-sector during the same period.

While the real estate activities (42.9%) and the narrow construction (42.6%) sub-sectors together accounted for 85.5% of the total number of enterprises in the broad construction sector in 2019, the share of architectural and engineering activities and the manufacturing sub-sectors stood at 8.1% and 6.4%, respectively.

Number of enterprises in the broad construction sector between 2010 and 2019

↑ 43.2%

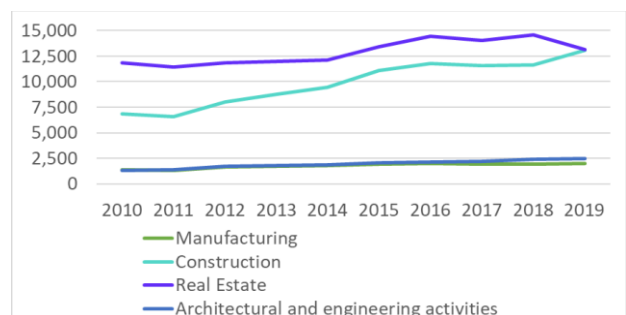
The **volume index of production** of the broad construction sector increased by 24.1% between 2015 and 2019 (Figure 2). Likewise, production in the construction of buildings and the construction of civil engineering grew by 47.4% and 8.8% respectively over the same period.

Volume index of production in the construction of buildings between 2015 and 2019

↑ 47.4%

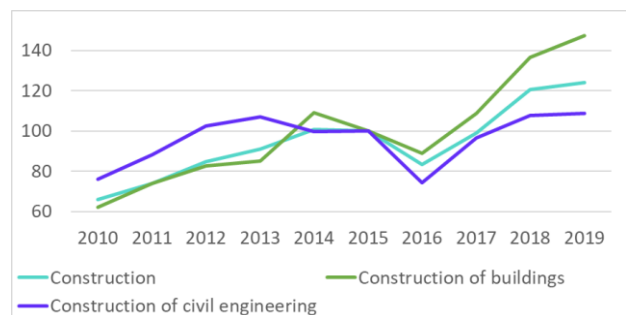
According to the head of Partnership of Latvian Constructors, the construction volumes in Latvia is expected to decline by about 5.0% in 2020, as compared to 2019, mainly due to COVID-19<sup>3</sup>.

Figure 1: Number of enterprises in the broad construction sector in Latvia between 2010 and 2019



Source: Eurostat, 2020.

Figure 2: Volume index of production in the Latvian broad construction sector between 2010 and 2019 (2015=100)



Source: Eurostat, 2020.

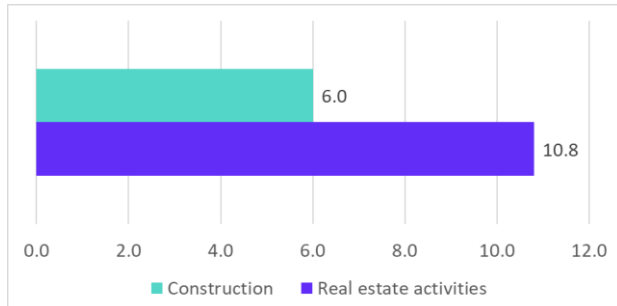
The **total value added at factor cost<sup>4</sup>** of the broad construction sector amounted to EUR 2.6 billion in 2019<sup>5</sup>, representing an increase of 103.0% since 2010. The narrow construction sub-sector accounted for 52.6% (EUR 1.4 billion) of the total value added in 2019, followed by the manufacturing (22.1%, i.e. EUR 579.6 million), the real estate activities (20.8%, i.e. EUR 544.6 million) and the architectural and engineering activities (4.5%, i.e. EUR 118.1 million) sub-sectors.

The **share of the gross value added (GVA)** of the broad construction sector in the GDP stood at 18.9% in 2017<sup>6</sup>, above the 2010 level (16.0%). Further, the share of GVA of the real estate activities sub-sector in the GDP stood at 10.8% (above the EU-27 average 9.7%) in 2019, followed



by the narrow construction sub-sector, being at 6.0%, and hence slightly above the EU-27 average of 5.0% (Figure 3).

Figure 3: Gross value added as a share of GDP in the Latvian broad construction sector in 2019<sup>7</sup> (%)



Source: Eurostat 2020.

## Productivity

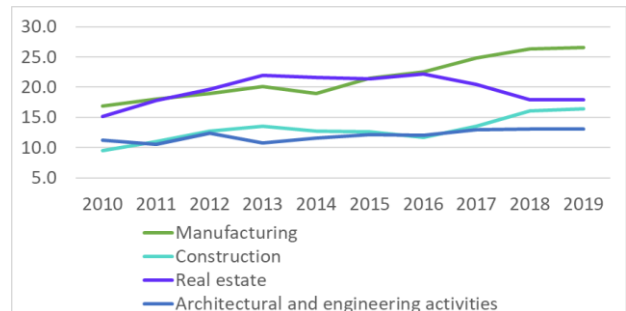
The **apparent labour productivity**<sup>8</sup> in the broad construction sector has been experiencing an increasing trend, growing from EUR 12,300 in 2010 to EUR 17,100 in 2017<sup>9</sup> (+38.9%), well below the EU-27 average of EUR 50,079 in the same year.

In terms of sub-sectors, the narrow construction sub-sector reported the highest increase of 72.5%, growing from EUR 9,500 in 2010 to EUR 16,385 in 2019<sup>10</sup>. This was followed by the manufacturing sub-sector (+57.0%), increasing from EUR 16,874 to EUR 26,497 in the same period. The real estate activities sub-sector reported an 18.1% growth, rising from EUR 15,200 in 2010 to EUR 17,950 in 2019<sup>11</sup>. Similarly, the architectural and engineering activities sub-sector reported the lowest growth of 17.1% over time, from EUR 11,200 in 2010 to EUR 13,118 in 2019<sup>12</sup>.

Apparent labour productivity in the narrow construction sub sector between 2010 and 2019 **↑ 72.5%**

In October 2019, Latvia appointed the University of Latvia think tank LV PEAK to represent the National Productivity Board. This is in accordance with the European Commission recommendation to set up a productivity board to boost productivity. The LV PEAK, founded in May 2018 by the University of Latvia and led by academics and experts, conducts independent analysis on productivity issues and formulates policy recommendations<sup>13</sup>.

Figure 4: Labour productivity in the broad construction sector in Latvia between 2010 and 2019 (EUR k)



Source: Eurostat, 2020.

## Turnover and profitability

The **total turnover** of the broad construction sector amounted to EUR 7.3 billion in 2017, registering a 54.4% above the 2010 levels (EUR 4.7 billion). It further increased to EUR 9.3 billion in 2019<sup>14</sup>, marking an increase of 95.9% since 2010. The growth was driven by increases in all the four sub-sectors, namely – the manufacturing (+131.9%), the narrow construction (+104.3%), the architectural and engineering activities (+60.1%) and the real estate activities (+46.6%) sub-sectors over the same period. In 2019, the largest share of the turnover came from the narrow construction sub-sector, which accounted for 59.8% (i.e. EUR 5.5 billion) of the total. It was followed by the manufacturing (21.8%, i.e. EUR 2.0 billion), the real estate activities (15.3%, i.e. EUR 1.4 billion), and the architectural and engineering activities (3.1%, i.e. EUR 283.4 million) sub-sectors.

Total turnover of the manufacturing sub-sector between 2010 and 2019 **↑ 131.9%**

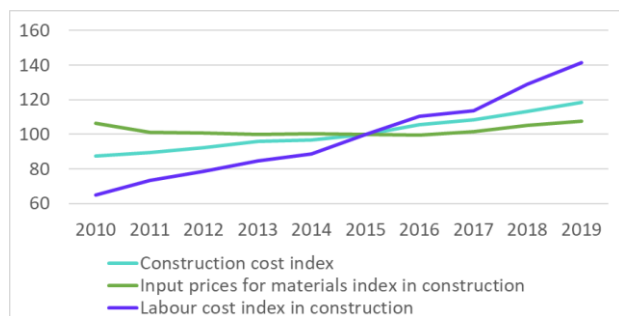
Similarly, the **gross operating surplus** of the broad construction sector increased from EUR 710.9 million in 2010 to EUR 1.1 billion in 2017<sup>15</sup>, 48.8% higher than the level registered in 2010. Notably, the highest growth was registered by the manufacturing sub-sector (+75.8%), followed by the narrow construction (+60.3%), the real estate activities (+34.1%) and the architectural and engineering activities (+7.6%) sub-sectors, over the same reference period.

At the same time, the **gross operating rate** of the broad construction sector<sup>16</sup>, which gives an indication of the sector's profitability, stood at 14.5% in 2017<sup>17</sup> (EU-27 average-16.6%), which is lower than in 2010 (15.0%). This indicates tighter profit margins, which are partly explained by increasing construction costs. The real estate activities sub-sector reported the highest gross operating rate of 31.2%, followed by the manufacturing (15.3%), and the architectural and engineering activities (14.7%) sub-sectors. Notably, the narrow construction sub-sector was the least profitable sub-sector, with a gross operating rate of 7.9% in 2017<sup>18</sup>.

Similarly, the **construction cost index** increased by 18.6% between 2015 and 2019. This was mainly due to a 41.4% increase in the labour cost during the same period (following the increase in wages). The input prices for materials, too, increased, albeit at a slower rate of 7.7% between 2015 and 2019 (Figure 5). Moreover, lengthy and cumbersome processes to obtain building permits have also contributed to high construction costs.

Labour costs index in construction between 2015 and 2019  **41.4%**

Figure 5: Construction cost index between 2010 and 2019 (2015=100)



Source: Eurostat, 2020.

According to Central Statistical Bureau of Latvia, the construction costs in Latvia increased by 0.1% in the third Quarter of 2020, over the previous quarter<sup>19</sup>.

Labour remuneration of workers and maintenance and operational costs of machinery and equipment grew by 1.1% and 0.4% respectively in the same period. However, prices of building materials decreased by 0.6%<sup>20</sup>.

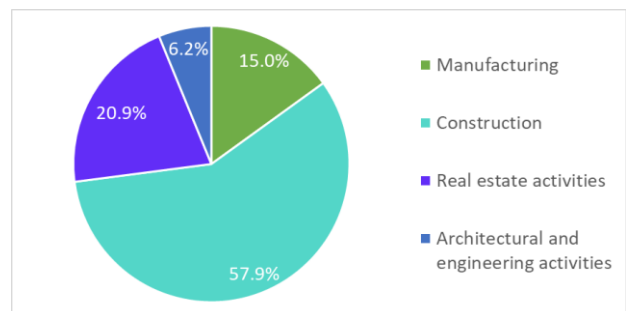
## Employment

In 2019<sup>21</sup>, there were 145,405 **persons employed** in the Latvian broad construction sector, 38.6% more than the 2010 levels (104,894). Specifically, the narrow construction sub-sector employed the 57.9% of the total construction workforce in 2019 (84,186 persons) – following a 59.0% incline compared to 2010 (52,954). This was followed by the architectural and engineering activities (+48.2%) and the manufacturing (+46.9%) sub-sectors, reaching 9,004 and 21,876 persons respectively in 2019. On the contrary, there was a 2.0% decline between 2010 and 2019 in the number of persons employed in the real estate activities sub-sector, standing at 30,340 persons in 2019 (Figure 6).

Furthermore, in 2017<sup>22</sup>, SMEs employed 90.1% of the total workforce in the broad construction sector, while the EU-27 average stood at 87.5%. This in turn, highlights the importance of SMEs in construction employment in Latvia.

Number of persons employed in the broad construction sector between 2010 and 2019  **38.6%**

Figure 6: Percentage of persons employed by broad construction sub-sectors in Latvia in 2019



Source: Eurostat, 2020.

As for **employment by specific occupation**, the number of technicians and associate professionals in the narrow construction sub-sector increased by 89.5% between 2010 and 2019, the highest occupational increase among the sub-sectors. This was followed by a 57.5% incline in the demand for workers in elementary occupations and 50.2% for craft and related trades workers. Meanwhile, demand for professionals in the narrow sub-sector witnessed a decline of 24.0% over the same period. In the manufacturing sub-sector, the largest growth was recorded in the number of

technicians and associate professionals (+68.8%) over the same period, which was trailed by an 18.2% rise in the number of clerical support workers. However, there was a decline in the demand for managers (-23.9%), plant and machine operators and assemblers (-14.2%) and professionals (-6.8%) in the same sub-sector between 2010 and 2019. On the contrary, the number of managers in the real estate activities sub-sector witnessed a 56.5% incline over the same reference period.

Demand for technicians and associate professionals in the narrow construction sub-sector during 2010-2019  **89.5%**

Additionally, the number of **self-employed workers** in the narrow construction sub-sector represented 10.9% of the total self-employed persons in the general economy in 2019. This is

below the EU-27 average of 11.9% but higher than the 2010 level of 8.0%. In the real estate activities sub-sector, the share of self-employed workers increased to 2.9% in 2019 from 2.8% in 2013<sup>23</sup>, thus standing comfortably above the EU-27 average of 1.4%.

In parallel, **full-time employment** in the narrow construction and the real estate activities sub-sectors increased by 44.6% and 10.0%, respectively, between 2010 and 2019, while in the manufacturing sub-sector, it grew by 4.6% over the same reference period. Meanwhile, **part-time employment** witnessed a decline of 24.3% and 10.3%, respectively, in the manufacturing and narrow construction sub-sectors.

Full-time employment in the narrow construction sub-sector between 2010 and 2019  **44.6%**



## 2

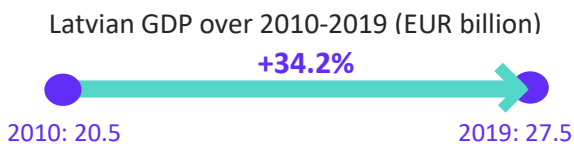
# Macroeconomic indicators

## Economic development

Over the 2010-2019 period, the Latvian GDP experienced an increase of 34.2%, reaching EUR 27.5 billion. In 2019, the country's GDP grew by 2.2%, lower than the growth posted in the previous year (4.3%)<sup>24</sup>.

In 2019, the drop in the growth rate was mainly due to the weakened external demand and matured investment cycle<sup>25</sup>.

In addition, the **potential GDP** amounted to EUR 26.6 billion in 2019, translating into a positive **output gap** of 3.5%. The positive output gap indicates that the Latvian economy tends to overwork its resources, with actual outputs exceeding full capacity output. The **inflation rate** stood at 2.7% in 2019, after experiencing a long period of fluctuation since 2010. This is slightly above the 2018 level (2.6%), mainly attributable to an increase in food and utilities price growth<sup>26</sup>.



## Demography and employment



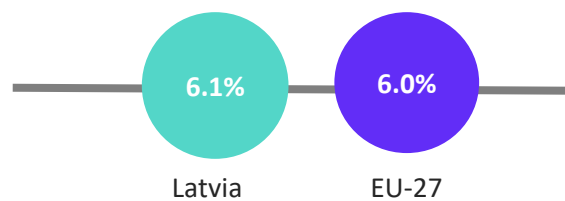
In 2019, the average unemployment rate in Latvia decreased to 6.1% in 2019 from 17.7% in 2010, thus standing almost at par with the EU-27 average of 6.0%.

In addition, **youth unemployment** (below the age of 25) reached 12.4% in 2019, below the EU-27 average of 15.1% and much below its peak level in 2010 at 36.2%<sup>27</sup>. The **total population** in Latvia stood at 1.9 million people in 2019, representing a decline of 8.5% since 2010. It is projected to further decline by 10.8% by 2030, and by 18.6% by

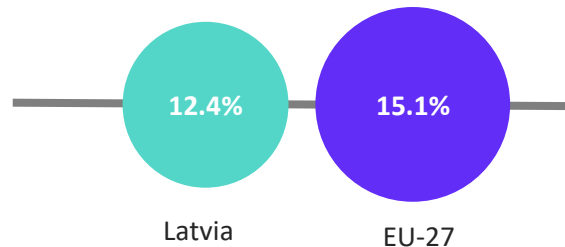
2050, reaching 1.4 million. Since 2010, the **net migration rate** has remained negative, emphasising the increasing emigration of Latvian citizens. However, in 2019, the net migration rate declined by 90.6% dropping to -3,360 people from -35,640 in 2010.

At the same time, the **working age population** in Latvia made up 63.9% of the total population in 2019, slightly below the EU-27 average of 64.6%. By 2050, the share of the working age population is expected to decrease to 55.0%. On the other hand, the **aged population** (65 years or older) made up 20.3% of the total population in 2019, being on the same level as the EU-27 average. By 2050, the share of the aged population in Latvia is expected to increase to 31.2%. This shift in terms of population may imply an increasing need for adequate care buildings and infrastructure. This in turn may generate more opportunities for the Latvian construction sector.

Unemployment rate in 2019



Youth unemployment rate in 2019



## Public finance

In 2019, the **general government expenditure** in Latvia accounted for 38.9% of GDP, below the EU-27 average (46.7%) and the 2010 level (46.1%).

Conversely, the **general government deficit** decreased to -0.2% of GDP in 2019, from the 2010 levels of -8.7. This is also below the EU-27 average for 2019 (-0.6%). Lastly, the **general government gross debt** accounted for 36.9% of the country's GDP, below the 2010 level of 48.1% and the EU-27 average (77.8%).

The government debt-to-GDP ratio is expected to increase from 37% in 2019 to 44% in 2021, mostly due to the large government deficits in 2020 and 2021, as well as COVID related impact<sup>28</sup>.

## Entrepreneurship and access to finance

According to the **Global Competitiveness Report 2019** by the World Economic Forum, Latvia ranked 40<sup>th</sup> out of 141 economies in business dynamism<sup>29</sup>.

As per the report, the country ranked 27<sup>th</sup> in the time it takes to start a business (days) and 38<sup>th</sup> in the costs involved in starting a business. Latvia also ranked 40<sup>th</sup> in willingness to delegate authority, 47<sup>th</sup> in companies embracing disruptive ideas, 48<sup>th</sup> in growth of innovative companies<sup>30</sup>.

According to the **Small Businesses Act (SBA) Fact Sheet 2019**, Latvia is considered among the leaders in early-stage entrepreneurial activity. However, the status given to successful entrepreneurship and opportunity driven entrepreneurial activities are low. There is also a lack of a global governmental strategic approach, fostering entrepreneurial spirit in society by starting entrepreneurship education in the school curriculum and by providing guidance to specific groups of people on starting a business<sup>31</sup>.

According to the **2019 Survey on the Access to Finance of Enterprises (SAFE) report**, around 10.0% of SMEs in Latvia have reported **access to finance** is the most important concern, above the EU-28<sup>32</sup> average of 7.0%. Bank loans were a relevant form of financing for around 42.0% of SMEs in Latvia (EU-28 average: 45.0%). Between April and September 2019, around 21.0% of SMEs applied for a loan (EU-28 average: 24.0%), while 6.0% did not apply due to fear of their application getting rejected (EU-28 average: 4.0%)<sup>33</sup>.

The **loans to non-financial corporations in the general economy** in Latvia declined by 42.0%, reaching EUR 5,151.0 million in 2019 from EUR 8,888.0 million in 2010. This reflects worsening conditions of access to finance in the country.

In Latvia, venture capital constitutes the main source of financing for start-ups. A steady, yet slow increase in the availability of venture capital has been observed in recent years in the country, which has partially improved access to finance for Latvian SMEs<sup>34</sup>.

In order to support entrepreneurship and boost the spirit of entrepreneurship in society, '**Support for start-ups - changes in procedures for applying and administering aid**' (*Atbalsts jaunuzņēmumiem - izmaiņas pieteikšanās noteikumos un administrēšanā*), was adopted as a measure during the 2018 period to the first quarter of 2019. Under this, two application criteria were improved to support more start-ups. The period to receive investments from venture capital was extended from 12 months to 24 months, which is part of the main criteria for participation in the support programme. Similarly, start-ups with venture capital investments of at least EUR 150,000 may now apply for two consecutive periods of support<sup>35</sup>.

According to the **Global Competitiveness Report 2019**, Latvia ranked 85<sup>th</sup> out of 141 economies in financial systems<sup>36</sup>.

In order to improve financing for SMEs in Latvia, the government made '**Acceleration funds**' (*Akselerācijas fondi*) fully operational. In total, three acceleration funds (BuildIT Latvia, the Commercialisation Reactor Fund, and Overkill Ventures) amounted to EUR 15.0 million (EUR 5.0 million for each), for the 2014-2020 programming period. The programme has been operational since the third quarter of 2018. Support to entrepreneurs is provided in two phases – pre-seed funding phase (where SMEs are allotted up to EUR 50,000) and seed financing phase (where SMEs are allotted up to EUR 250,000)<sup>37</sup>.

## 3

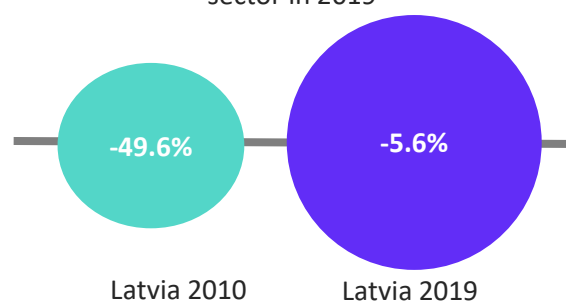
## Key economic drivers of the construction sector

### Business confidence

Despite remaining in negative territory, all confidence indicators have shown significant signs of improvement since 2010.

The **consumer confidence** indicator stood at -3.8 in 2019, considerably better than 2010 (-25.1) and EU-27 average of -6.2. Similarly, the **industry confidence** indicator improved from -7.6 in 2010 to -1.8 in 2019. This also stands well above the EU-27 average of -4.8 in 2019. Further, the **construction confidence** indicator registered a substantial improvement over the 2010 and 2019 period, rising from -49.6 to -5.6. This, however, is lower than the EU-27 average of 5.1 in 2019.

Confidence index in the construction sector in 2019



Following this trend, the **investment ratio** also increased from 19.7% in 2010 to 23.8% in 2019. Likewise, **investment per worker** has been increasing from EUR 10,710 in 2010 to EUR 13,424 in 2017<sup>38</sup>.

In terms of sub-sectors, investment per worker in the real estate activities and the narrow construction sub-sectors increased (49.2% and 20.9% respectively) from EUR 18,700 and EUR 2,600 in 2010 to EUR 27,900 and EUR 3,300 in 2017<sup>39</sup>, respectively. Conversely, investment per worker in the architectural and engineering activities sub-sector decreased by 55.9%, from EUR 3,400 in 2010 to EUR 1,500 in 2017<sup>40</sup>.

### Domestic sales

The ranking of the five **most domestically sold construction products** in Latvia has seen some fluctuations in recent years. Four out of the top five ranked product groups showed significant growth in their sales value between 2010 and 2019. 'Doors, windows and their frames' being the second most domestically sold construction product, experienced the largest increase in sales value, with a 621.1% incline. This incline was followed by 'Prefabricated buildings of metal' (+462.5%), 'Ready-mixed concrete' (+171.7%) and 'Windows, French windows and their frames' (+144.6%) over the 2010-2019 period. Notably, the product group 'Other worked ornamental or building stone' recorded a 229.5% growth over the same reference period. This product, however, doesn't belong to the top five most domestically sold construction products in the country in 2019. Further, the top five most domestically sold construction products, accounting for 67.8% of the total of construction products sold domestically in 2019, are presented in the table below (Table 1), including a comparison with the most sold products in the EU-27 region.

Table 1: Five most domestically sold construction products in Latvia and in the EU in 2019

Latvia				EU-27
	Product	Value (EUR m)	Share in construction product domestic sales (%)	Product
1	Other plywood, veneered panels, etc. (group 162118)	70.5	16.3	Other structures and parts of structures, plates, etc. (group 251123)
2	Doors, windows and their frames, etc. (group 251210)	69.3	16.1	Doors, windows and their frames (group 251210)
3	Prefabricated buildings of metal (group 251110)	63.6	14.7	Ready mixed concrete (group 236310)
4	Ready-mixed concrete (group 236310)	59.5	13.8	Prefabricated buildings of metal (group 251110)
5	Windows, French windows and their frames, etc. (group 162311)	29.4	6.8	Prefabricated structural components (group 236112)

Source: PRODCOM, 2020.

## Export of construction-related products and services

The ranking of the **most exported construction products** experienced some fluctuations in recent years. Most of the products strongly increased in terms of sales value of exports between 2010 and 2019. Indeed, robust exports has been a driving factor in the country's economic upswing. Notably, the largest increase in value of exports was seen in product group 'Boards, blocks and similar articles' (+2024.5%), followed by a 1146.7% increase in 'prefabricated structural components for building or civil engineering, of cement, concrete or artificial stone', over the period 2010 and 2019. However, these two products were not in the top five list and together accounted for just 6.1% of the total construction product exports in 2019. The top five most exported construction products from Latvia and the EU-27 are summarised in Table 2. Together, these five products made up 59.4% of all construction products exports in 2019.

Table 2: Five most exported construction products in Latvia and in the EU in 2019

Latvia				EU-27
	Product	Value (EUR m)	Share in construction product export sales (%)	Product
1	Pellets and briquettes, of pressed and agglomerated wood (group 162915)	308.1	21.0	Ceramic tiles and flags (group 233110)
2	Other plywood, veneered panels and similar laminated wood (group 162118)	241.5	16.4	Other structures and parts of structures, plates, etc. (group 251123)
3	Oriented strand board (OSB) (group 162113)	122.3	8.3	Fibreboard of wood (group 162115)
4	Other structures and parts of structures, plates, etc. (group 251123)	106.0	7.2	Doors, windows and their frames (group 251210)
5	Pallets, box pallets and other load boards of wood (group 162411)	94.4	6.4	Marble, travertine, alabaster, worked, and articles thereof (group 237011)

Source: PRODCOM, 2020.

In terms of **cross-border provision of construction services**<sup>41</sup>, Latvia **exported** EUR 265.0 million worldwide in 2018<sup>42</sup>, registering an increase of 349.2% compared to the 2010 level of EUR 59.0 million. Of this total, 91.3% (i.e. EUR 242.0 million) went to the EU-27 in 2018. Similarly, the country imported EUR 59.0 million worth of construction services worldwide in 2018<sup>43</sup>, an increase of 18.0% over the 2010 level (EUR 50.0 million), with 93.2% (i.e. EUR 55.0 million) coming from the EU-27 countries. Thus, this generated a **trade surplus** of EUR 206.0 million for the year.

Latvia's export of construction services worldwide between 2010 and 2018

↑ 349.2%

## Access to finance in the construction sector

Access to finance for Latvian construction companies has become an increasingly pressing issue since the economic crisis. In particular, lending to the construction sector has seen a declining trend since 2010. **Outstanding loans** to the narrow construction sub-sector have fallen from EUR 991.5 million in 2010 to EUR 153.8 million in 2019, witnessing a fall of 84.5%.

This again is reflected in the fact that construction firms report the lowest share of external financing in their funding structure, being at 22.0%<sup>44</sup>.



The EIB Investment Survey (EIBIS) for 2019 shows that 18.0% of firms in the Latvian construction sector are dissatisfied with the cost, 14.0% with the collateral, 12.0% with the amount and 10.0% with the maturity of financing<sup>45</sup>.

Even though there has been a decline in the overall number of loan rejections, around 12.0% of Latvian firms are still financially constrained. This is higher than the EU-28<sup>46</sup> average of 5.0%. The report further suggests that around one in five SMEs and construction firms are constrained (20.0% and 18.0%, respectively)<sup>47</sup>.

The European Investment Fund (EIF) supports SMEs, and the construction sector, through its activities. Specifically, **BaltCap Private Equity Fund III**, a venture capital investment fund in the Baltics, aims to generate long-term capital gains from equity and quasi-equity investments in SMEs, mainly in Latvia, Estonia and Lithuania<sup>48</sup>.

Additionally, Latvia's state-owned development institution, ALTUM, has signed a microfinance guarantee agreement with EIF under the EU Programme for Employment and Social Innovation (EaSI). Through the agreement ALTUM will provide EUR 15.0 million loans to 600 micro-businesses between 2018 and 2021. The scheme, which

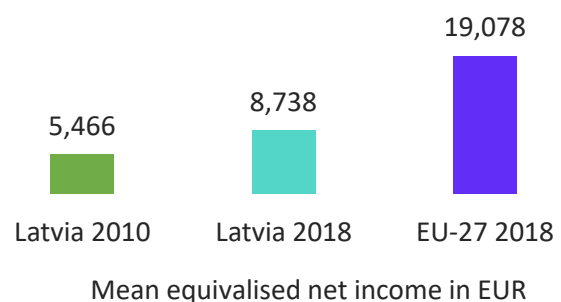
primarily targets start-ups and small businesses will provide these loans at relatively lower interest rates and collateral requirements<sup>49</sup>.

According to the SBA Fact Sheet 2019, the **Portfolio Guarantee Instrument (PGI)** was created to support the already existing variety of financial instruments which are developed, managed and issued by ALTUM. The PGI is aimed at providing state aid to SMEs in the form of guarantees for financial services provided by a credit institution<sup>50</sup>.

## Access to housing

The **number of households** in Latvia increased, reaching 865,800 in 2019 from 809,100 in 2010 (+7.0%). At the same time, the share of total **population living in cities and greater cities** rose to 43.4% in 2018<sup>51</sup> from 42.9% in 2011<sup>52</sup>. While in 2010, 46.7% of the total population lived in densely populated areas, in 2019, it reduced to 43.8%. However, the share of the population living in intermediate urbanised areas increased to 19.1% in 2019 from 2.3% in 2010.

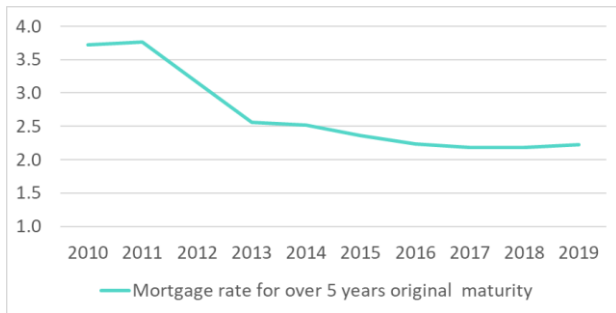
Furthermore, the **mean equalised net income** has grown by 78.4% over the period 2010-2019, reaching EUR 9,749.0 from EUR 5,466.0. However, in 2018, it amounted to EUR 8,738.0, below the EU-27 average of 19,078.0<sup>53</sup>.



Moreover, the **interest rates on mortgages** (for loans over five years of original maturity), have been declining from 3.7% in 2010 to 2.2% in 2019, remaining almost stable since 2016 (Figure 7). Nevertheless, total **outstanding residential loans to households**, also decreased from EUR 6.6 billion in 2010 to EUR 4.1 billion in 2018<sup>54</sup> (-37.5%).



Figure 7: Mortgage rates for loans over 5 years original maturity (%)



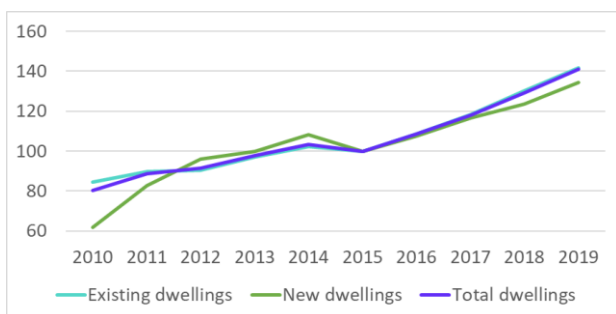
Source: European Central Bank, 2020.

In addition, the **house price index** for total dwelling units increased by 40.9% between 2015 and 2019. This trend is partly driven by the house price index for existing dwelling units, which rose by 41.8% over the same period (Figure 8). At the same time, the increase in house prices has been supported by the steady wage growth of recent years and government supported programmes for house purchase, which was introduced in 2015 and expanded further in 2018.

House prices index for total dwellings between 2015 and 2019 ↑ **40.9%**

As per the housing affordability index compiled by one of the Baltics' leading commercial banks, of the three Baltic capitals, house prices remained most affordable in the Riga region<sup>55</sup>.

Figure 8: House price index in Latvia between 2010 and 2019 (2015=100)



Source: Eurostat, 2020.

Regarding the **building permits** index for residential dwellings, Latvia witnessed an increase of 67.7% between 2015 and 2019. Similarly, building permits for one-dwelling buildings rose by 47.5% over the same reference period. Further, the biggest incline was seen in the building permits

for two and more dwelling buildings, rising by 106.7% between 2015 and 2019.

Building permits index for residential dwellings between 2015 and 2019 ↑ **67.7%**

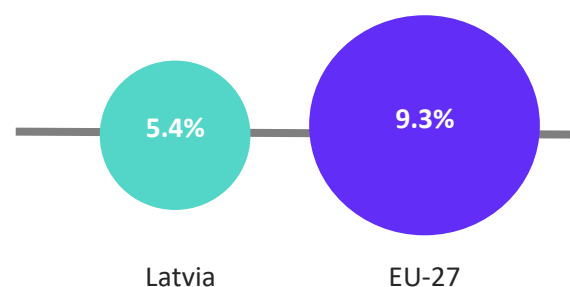
Most of the Latvian **building stock** is owner-occupied, with 80.2% owners occupying buildings in 2019, however below the 2010 level (84.3%). While 19.8% of building stock was occupied by tenants in 2019, as compared to 15.7% in 2010. This can be partly attributed to the state policies that favour home ownership.

New housing construction in Latvia is hindered by several factors, such as, lengthy and cumbersome processes for obtaining planning and building permits, poor protection of landlords' interests in the rental law and a reluctance of banks to lend for projects outside of Riga<sup>56</sup>.

At the same time, the home ownership rate for the population earning **above 60.0% of the median equalised income** reached 81.9% in 2019 as compared to 87.5% in 2010. Similarly, the home ownership rate for the population earning **below 60.0% of the median equalised income** stood at 74.7% in 2019, above the 2010 level of 72.1%.

In 2019, the **overcrowding rate**<sup>57</sup> in Latvia stood as high as 42.2%<sup>58</sup>, surpassing the EU-27 average of 17.1%. Similarly, the **severe housing deprivation rate**<sup>59</sup> stood at 12.7%<sup>60</sup>, three times higher than the EU-27 average of 4.0%. Last, the **housing cost overburden rate**<sup>61</sup> has been falling since 2013 (11.4%), standing at 5.4% in 2019, below the EU-27 average of 9.3%. This decline indicates that the pressing issue of housing affordability is being addressed, despite rising house prices<sup>62</sup>.

Housing cost overburden rate in 2019



Access to adequate housing, particularly for low-income groups remain a challenge and

homelessness is not addressed at the national level<sup>63</sup>.

## Infrastructure

According to the 2019 Global Competitiveness Report<sup>64</sup>, Latvia ranks 43<sup>rd</sup> out of 141 economies in infrastructure.

With an overall ranking of 52<sup>nd</sup> out of 141 economies, Latvia performs well in transport infrastructure. In particular, it ranks 15<sup>th</sup> in efficiency of air transport services, 21<sup>st</sup> in train services and 27<sup>th</sup> in road connectivity. Further, it also performs well in terms of railroad density (30<sup>th</sup>) and efficiency of seaport services (34<sup>th</sup>). In contrast, the country lags in airport connectivity (82<sup>nd</sup>), liner shipping connectivity (94<sup>th</sup>) and quality of road infrastructure (95<sup>th</sup>)<sup>65</sup>.

Latvia ranks third last among the EU Member States in the quality of road infrastructure, after Romania and Malta. Despite recent improvements, the quality of road infrastructure in the country remains well below the European average. In fact, Latvia recorded one of the highest fatality rates on roads at 70 deaths per million inhabitants in 2017 (EU-28<sup>66</sup> average is 49). The country scores significantly above the EU-28<sup>67</sup> average in completion of the TEN-T Core Road Network, with

100% of it being complete<sup>68</sup>. With the purpose of increasing the traffic flow and to move lorry traffic away from residential areas, Latvia has launched its first **public-private partnership** project to design and construct the *Kekava* bypass on the European Route E67<sup>69</sup>.

Also, the construction of Rail *Baltica* project, which will act as a linkage between the three Baltic countries and Poland and therefore to the rest of the European rail network, is not progressing as planned, with the State Audit Offices estimating the project to be delayed by more than two years. For the purpose of improving the transport infrastructure within and around Riga, two major projects are underway. Firstly, a major EU-funded **rail electrification project** is planned to begin in 2020. In its first phase, 314 kilometres of rail would be electrified by 2023, increasing the share of electrified track from 14.0% to 30.0%. Secondly, the country has begun **investing in new trains** to increase the attractiveness of rail commutes and thereby increase the usage of public transport for commuting<sup>70</sup>. In November 2020, General constructor partnership *Bererix*, started the construction of Rail *Baltica* Central Hub in Riga, Latvia<sup>71</sup>.

## 4

# Key issues and barriers in the construction sector

## Company failure

Over the period 2010-2017<sup>72</sup>, **business demography** in the broad construction sector has changed considerably. **Company births** in the narrow construction sub-sector increased from 1,352 in 2010 to 1,864 in 2017 (+37.9%), after reaching its peak in 2015 (2,903), whereas there was a 46.4% incline in the architectural and engineering activities sub-sector, rising from 151 in 2010 to 221 in 2017. However, company births in the real estate activities sub-sector declined by 10.9%, falling from 1,425 in 2010 to 1,269 in 2017.

Company births in the narrow construction sub-sector between 2010 and 2017

↑ 37.9%

Furthermore, all the three sub-sectors registered declines in the number of **company deaths** over the same reference period. The real estate activities sub-sector recorded the largest decline of 68.6% in company deaths (from 1,301 in 2010 to 409 in 2017). This was followed by a 39.7% decline in the narrow construction sub-sector (1,081 in 2010 to 652 in 2017) and a 16.2% fall in the architectural and engineering activities sub-sector (from 99 in 2010 to 83 in 2017).

Company deaths in the real estate activities sub-sector between 2010 and 2017

↓ 68.6%

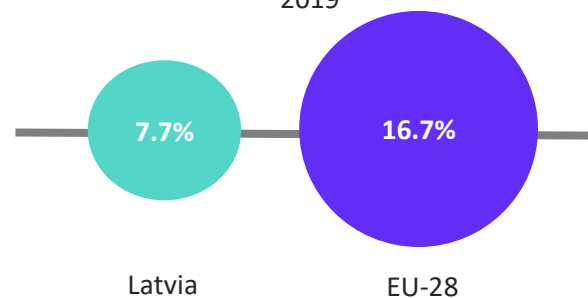
According to the Euler Hermes' Insolvency estimates, the number of companies that became insolvent in Latvia in 2019 reduced to 557 from 593 in 2018. However, owing to the COVID-19 impact, it is forecasted that this number will rise to 750 by the end of 2021<sup>73</sup>.

## Trade credit

According to the SAFE 2019 report, trade credit constitutes a relevant source of financing for only 15.6% of Latvian SMEs, below the EU-28<sup>74</sup> average of 31.0% in 2019<sup>75</sup>.

Only 7.7% of the SMEs have obtained trade credit from their business partners in the last six months. Further, 33.2% of the SMEs have applied for trade credit in the last six months, while the EU-28<sup>76</sup> average stood at 31.7%. Out of 33.2% of SMEs who applied for trade credit in the last six months, 67.3% SMEs received everything they applied for. This stands below the EU-28<sup>77</sup> average of 73.5% in 2019. Also, 57.2% of the SME respondents consider availability of trade credit has remain unchanged over the past six months and 60.3% of SMEs expect trade credit financing to remain unchanged in the six months following the survey<sup>78</sup>.

Share of companies using the trade credit in 2019



## Late payment



According to the European Payments Report 2020, late payment has emerged as a concern in Latvia with 55.0% of businesses being affected by issues with late payment from customers over the past 12 months<sup>79</sup>.

On average, business-to-business (B2B) customers in Latvia are allowed 47 days to pay their dues, which is almost at par with the EU-28<sup>80</sup> average of 46 days. For public administration-to-business transactions (PA2B), the average contractual payment terms allowed is 58 days, compared to EU-28 average of 53 days. However, in practice it takes 63 days to settle a B2B transaction (EU-28 average – 60 days) and 77 days to settle a PA2B transaction (EU-28 average – 68 days). As per the report, 53.0% Latvian firms consider the issue of late payment as a real risk to the sustainable growth of business (EU-28 average – 46.0%). As a result, almost two-third (64.0%) of Latvian businesses want to see voluntary initiatives from corporations to solve this problem<sup>81</sup>.

Further, with the onset of the COVID-19 pandemic, the situation has become more difficult. According to the European Payment Report 2020, 50.0% of the respondents in Latvia say late payments have a high impact on the liquidity squeeze. This is higher than the EU-28<sup>82</sup> average of 45.0%<sup>83</sup>.

Amid this challenging environment, businesses are being pushed to accept unfavourable payment terms. As per the European Payment Report 2020, 73.0% of the overall SME respondents from the real estate and construction sectors have agreed to accept longer payment terms in order to avoid damaging client relationships. Country-wide, 76.0% of the SME respondents from Latvia have agreed to accept longer payment terms, lower than the EU-28<sup>84</sup> average of 69.0%<sup>85</sup>.

**While only 9.0% of the respondents saw the risk of late/non-payments increasing during the next 12 months in 2019, it went up to 43.0% in 2020, owing to the COVID-19 pandemic<sup>86</sup>.**

## Time and cost of obtaining building permits and licenses

As per the 2020 World Bank's Doing Business Report<sup>87</sup>, Latvia ranked 56<sup>th</sup> out of 190 economies in 'dealing with construction permits', equal to last year's ranking<sup>88</sup>.

As per the report, it requires 14 procedures and 192 days in total to complete the formalities to build a warehouse<sup>89</sup>. This is higher than the OECD high-income average (12.7 procedures and 152.3 days) (Table 3). The cost of obtaining a building permit for a warehouse represents 0.4% of the value of the warehouse, below the OECD high-income average of 1.5%.

Table 3: Construction procedures timing and costs in Latvia

Procedure	Time to complete	Associated costs
Obtain topographic survey of the land plot	24 days	EUR 475
Obtain geo-technical study of the land	21 days	EUR 1,000
Request and obtain a building permit	30 days	EUR 1,409
Obtain technical requirements from the State Environmental Service of the Republic of Latvia	28 days	no charge
Obtain technical requirements from water and sewage company	21 days	no charge
Obtain design clearance from water and sewage company	7 days	no charge
Obtain a note in the construction permit regarding execution of the design conditions	21 days	no charge
Obtain a note in the construction permit regarding execution of the conditions for commencing construction work	7 days	no charge
Receive inspection by the State Environmental Service of the Republic of Latvia	1 day	no charge
Receive inspection by Fire Safety and Rescue Department	1 day	no charge
Obtain measurements from State Land Service	27 days	EUR 263
Obtain water and sewerage connection	20 days	EUR 37
Receive on-site inspection and obtain the final handover certificate	5 days	no charge
Register the building in the land book	20 days	EUR 23

Source: Doing Business overview for Latvia, World Bank 2020

## Skills shortage



The number of job vacancies in the narrow construction sub-sector experienced an increase of 444.9%, rising from 594 in 2010 to 3,236 in 2019.

Similarly, job vacancies in the real estate activities sub-sector increased from 99 in 2010 to 289 in 2019 (+192.7%). In line with this, the **job vacancy rate** in the narrow construction sub-sector recorded its decade's highest, standing at 4.8% in 2019 (1.3% in 2010). Further, in the real estate activities sub-sector, job vacancy rate stood at 1.0% in 2019, compared to 0.4% in 2010.

Number of job vacancies in the narrow construction sub-sector during 2010-2019

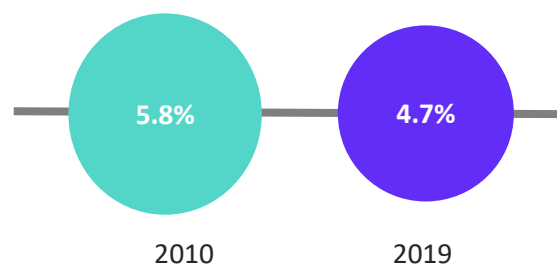
↑ 444.9%

Skills shortages remain as one of the biggest challenges for the sector's growth. A lack of qualified professionals is observable from enrolment in trade schools to engineering and design studies. There is also a need for construction managers, water and wastewater engineers and roofers.

At the same time, the **number of tertiary students** in engineering, manufacturing and construction suffered a decline of 20.6% between 2010 and 2018<sup>90</sup>, falling to 1,958 from 2,465. The number of tertiary students in architecture and building fell (-38.1%), followed by a 12.4% and 9.1% decline in manufacturing and processing and engineering and engineering trades, respectively, over the same reference period.

Further, **adult participation in education and training** in the narrow construction sub-sector has generally been fluctuating over the years, declining from 5.8% in 2010 to 4.7% in 2019, after reporting a high at 7.2% in 2017. In the real estate activities sub-sector, adult participation in education and training stood at 10.0% in 2017<sup>91</sup>.

Adult participation in education and training in the narrow construction sub-sector



Skills shortages and mismatches also limits productivity growth. Low and medium-skilled workers can switch between specialisations, depending on the available job offers, because they do not require a document certifying their qualification. While this offers flexibility for construction workers, it does not allow them to acquire a true specialisation and associated skills<sup>92</sup>.

Furthermore, the major gaps in skills include a lack of understanding about energy efficiency solutions, the use of new technologies and nearly zero energy buildings. In particular, regarding roofers, plasterers, carpenters and installers, there is a need to improve their skills on building airtightness and construction leakage prevention, as renovations make up about 90.0% of their work<sup>93</sup>.

Latvia adopted a construction industry development strategy for 2017-2024 to address various industry issues, such as, ensuring a qualified workforce, increasing productivity, reducing administrative barriers and improving the quality of construction services<sup>94</sup>.

By 2025, the deficiency of adequately skilled manpower in Latvia is expected to exceed 17,000, with construction and civil engineering, being one of the key sectors affected. Moreover, data from the State Employment Agency suggest that almost 86.0% of vacancies in Latvia in 2019 were registered with profession groups requiring low to medium levels of qualifications like construction workers, bricklayers, builders, carpenters, and unskilled road construction workers, among others. In fact, the number of vacancies in the construction sector has increased in 2019, indicating a severe shortage of manpower across skillsets<sup>95</sup>.



Moreover, job opportunities are concentrated in urban areas, but labour mobility remains hindered by the shortage of affordable housing and poor transport connections.

**Labour supply is expected to continue falling due to emigration and natural decline in the population. This in turn will lead to further labour shortages and skill mismatches in the country<sup>96</sup>.**

To counteract the shortage of skilled workers in a number of sectors in the national economy, the Ministry of Economics drafted a list of 29 sub-groups of professions where there is currently a significant lack of workforce and which could benefit from the influx of foreign specialists<sup>97</sup>. To this end, the Ministry introduced **preferential conditions to attract highly qualified specialists from abroad** in the identified professions. Among the shortage occupations feature construction technicians, civil engineers and sustainable construction engineers<sup>98</sup>.

## Sector and sub-sector specific issues

### Material efficiency and waste management

Owing to a rise in economic activity and specifically in construction, **waste generated by the construction sector** has increased in recent years. In the European Union, construction and demolition waste (CDW) constitute one of the biggest waste streams. CDW accounts for approximately 25.0% - 30.0% of all waste generated in the EU. CDW mainly consists of several materials, including concrete, bricks, gypsum, wood, glass, metals, plastic, solvents, asbestos and excavated soil, many of which can be recycled<sup>99</sup>.

The bulk of **CDW** is made up for 81.0% of waste soil and stones, with the remainder segregated wastes such as rubble, concrete, bricks, glass, plastic, wood, metals and mixed CDW. In 2018<sup>100</sup>, construction activities alone generated a total waste of 310,772 tonnes in Latvia. This was 1,342.0% higher than the waste generated in 2010, 21,551 tonnes<sup>101</sup>.

Waste generated from construction activities in Latvia between 2010 and 2018

 **1,342.0%**

Waste management in Latvia, including CDW, is governed by the **Waste Management Law** of 2010<sup>102</sup>. It establishes general requirements and procedures for waste management and prevention. In addition, the **Natural Resources Tax Law**<sup>103</sup> imposes mandatory fees to “high polluters” in order to encourage pollution reduction and waste management implementation. The **National Waste Management Plan 2013-2020** also sets out practices and objectives to curb the generation of waste in the country.

More specifically, the Construction Law and Construction Regulations also set principles for environmental protection, fostering sustainable construction and the effective use of natural resources. For instance, recycling and recovery of waste generated during construction activities should be promoted and all hazardous construction waste should be managed in accordance with the regulatory enactments regarding hazardous waste<sup>104</sup>.

As per the OECD Environmental Performance Review 2019, Latvia now has specific provisions for CDW with recovery, reuse and recycling targets specified in the **State Waste Management Plan 2013-2020**, which was seldom monitored and given little attention earlier. Producers of non-hazardous CDW must ensure that by 2020, 70.0% of all CDW generated in a year is reused, recycled, or recovered, including through backfilling. However, constraints such as underdeveloped market for recycled aggregates, availability of natural aggregates at lower prices and non-existence of any financial incentives, other than the NRT on material extraction, act as a barrier towards the achievement of the set goals in this regard. Despite the constraints, Latvia surpassed the 70.0% target, achieving 88.0% recovery or recycling of CDW waste back in 2015<sup>105</sup>.

## Climate and energy

Latvia is among EU's top performers in renewable energy, with greenhouse gas emissions per capita being among the lowest in EU. Also, the country is about to achieve its 2020 emission reduction target<sup>106</sup>.

**Emissions** of greenhouse gases (carbon dioxide, methane and nitrous oxides) from the narrow construction and real estate activities sub-sectors in Latvia amounted to a total of 242,993 tonnes

and 126,158 tonnes in 2018<sup>107</sup>, respectively. While emissions in the narrow construction sub-sector increased slightly by 2.4% during the period 2010-2018, emissions in the real estate activities sub-sector declined by 5.2% over time<sup>108</sup>. This indicates that the country is progressing well in containing its greenhouse gas emissions.

## 5

# Innovation in the construction sector

## Innovation performance

According to the European Innovation Scoreboard 2020, Latvia is classified as a Moderate Innovator, with a continuous increase in performance since 2016<sup>109</sup>.

As per the report, finance and support and employment impacts are the strongest innovation dimensions of Latvia. Further, areas of population with tertiary education, venture capital expenditures, trademark applications and employment in fast-growing enterprises are high ranking indicators in the scoreboard. On the other hand, innovators, attractive research systems and sales impacts are the weakest innovation dimensions. New-doctorate graduates, R&D expenditure in the business sector and Public-private co-publications are low ranking indicators in the scoreboard<sup>110</sup>.

In the broad construction sector, **business enterprise R&D expenditure (BERD)** in the professional, scientific and technical activities sub-sector<sup>111</sup> decreased from EUR 6.1 million in 2010 to EUR 2.9 million in 2017<sup>112</sup>. This represents a decline of 52.4% over the 2010-2017 period. BERD in the narrow construction sub-sector attained a level of EUR 0.4 million in 2017, from zero in 2010<sup>113</sup>.

BERD expenditure in professional, scientific and technical activities sub-sector between 2010 and 2017

↓ 52.4%

In parallel, the **total R&D personnel** (full-time equivalents – FTE)<sup>114</sup> in the broad construction sector dropped across all sub-sectors as of 2010. The total **R&D personnel** in the professional, scientific and technical activities sub-sector declined from 313 in 2010 to 69 in 2017<sup>115</sup> (-78.0%). Similarly, FTE in the narrow construction

sub-sector declined from 10 in 2010 to only seven in 2016<sup>116</sup> (-30.0%), demonstrating the low levels of private sector engagement in R&D in the Latvian construction sector.

R&D funding in Latvia is also very low, as it stood at EUR 137.9 million, comprising of 0.5% of GDP, well below the targeted level of 1.1%. Low investments in R&D will negatively affect the long-term growth in the country and will limit the possibilities of developing knowledge and technology-intensive industries and achieving higher productivity<sup>117</sup>.

Furthermore, the limited innovative capacity of Latvian construction companies is demonstrated by the low number of **construction-related patent applications** registered. The country has filed only one such patent application in 2019.

During the 2010-2019 period, only six patent applications have been filed by Latvia. No Latvian construction and materials firms rank within the top 1,000 EU companies by R&D, according to the 2019 EU R&D Scoreboard<sup>118</sup>.

As per the 2019 SBA Fact Sheet, Latvia has performed below in terms of innovation in comparison with the EU-28<sup>119</sup> average. The indicators in Latvia such as share of SMEs bringing product/process, marketing or in-house innovations, share of SMEs purchasing and selling online, turnover from e-commerce, national R&D available to SMEs, and many other indicators rank below the EU-28 average<sup>120</sup>.

However, innovation is an area which has been a top priority for Latvian government since 2014, but the overall performance in this area has been moderate. Between the period 2018 and first quarter of 2019, two measures were adopted for promoting innovation in SMEs<sup>121</sup>:

- **support for the development of new products and technologies within competence centres, Round 4 (Jaunu produktu ieviešana ražošanā 4. kārtā):** As

per the measure, the companies will be able to receive support for industrial research, experimental development and technical economic feasibility studies for research projects within one competence centre. An additional funding of EUR 37.0 million has also been allocated from European Regional Development Fund (ERDF)<sup>122</sup>.

- an amendment to the existing technology transfer programme, '**Innovation voucher support for SMEs (Inovāciju vaučeri)**' had been implemented. This intends to raise interest in this type of support and improve the level of innovation in SMEs. This programme is being implemented by the Latvian Investment and Development Agency, with a total allocation of EUR 2.8 million from the EU Structural Funds. New activities — which form part of the technology transfer programme — include external experts for innovation audit and designer services to introduce new products<sup>123</sup>.

## Eco-innovation and digitalisation

**As per the Eco-Innovation Scoreboard (Eco-IS) 2019, Latvia scored 86 in comparison to the EU-28<sup>124</sup> average of 100, falling under the Average Eco-I performers group<sup>125</sup>.**

As per the report, Latvia's score was above the EU-28<sup>126</sup> average on two indicators, namely; eco-innovation inputs and socio-economic outcomes. For the remaining three indicators – eco-Innovation inputs, eco-Innovation activities and resource efficiency outcomes, the country scored below the EU-28 average<sup>127</sup>.

According to the **European Commission Digital Economy and Society Index (DESI) 2020**, Latvia ranked 18<sup>th</sup> with a score of 50.7, out of EU-28<sup>128</sup> Member States (average score: 52.6). This signifies a drop in 2020 ranking, but improvement in score, in comparison with 2019 (rank: 15<sup>th</sup> and score: 49.9). As compared with 2019, Latvia improved its score in 2020 in terms of connectivity, use of internet services, integration of digital technology and digital public services. However, its score in human capital dropped in 2020, as compared to 2019<sup>129</sup>.

Among all dimensions, Latvia ranked highest in connectivity (4<sup>th</sup>), followed by digital public services (5<sup>th</sup>), integration of digital technology (23<sup>rd</sup>) and use of internet services (19<sup>th</sup>), human capital (24<sup>th</sup>)<sup>130</sup>.

As per the **EIB Investment Survey 2019**, the number of firms using digital technologies in the Latvian construction sector were lower than the EU-28<sup>131</sup> average. Specifically, around 17.0% of Latvian businesses adopted using Internet of things (IOT), below the EU-28 average of 26.0%. In terms of using drones, around 13.0% of Latvian businesses reported their usage, less than the EU-28<sup>132</sup> average (21.0%). Moreover, 4.0% and 2.0% of Latvian businesses have reported using 3-D printing and augmented reality, in comparison with 11.0% and 12.0% of businesses in the EU-28<sup>133</sup> average, respectively<sup>134</sup>.

The Latvian National Development Plan 2014-2020, the Transport Development Guidelines 2014-2020 and the National Roads Programme 2014-2020 of Latvia list the investment in the development and modernisation of Latvia's transport infrastructure, in particular, roads and railways, as a priority. In this context, the Latvian public sector is taking steps towards the **building information modelling (BIM)**<sup>135</sup>.

With regards to implementation of BIM in Latvia, a public organisation named the **Latvian Building Information Modelling Society (LatBIM)** was founded in 2014. LatBIM aims at promoting development of BIM throughout Latvia and cooperating with state and local authorities, European and global BIM organisations. Amongst others, it prepares technical documentation work orders and quality requirements for BIM construction designs. It also organises events for municipalities, construction boards or trade missions<sup>136</sup>.

**In 2019, the Riga Technical University partnered with two other Baltic universities and established a knowledge and innovation contact point – EIT Raw Materials Baltic Hub. The hub aims to address the shortage of raw materials in construction, energy and water management in the Baltic states<sup>137</sup>.**

## Country Fact Sheet Latvia

The hub will also focus on innovations in these sectors. The hub will also implement three programs successively in the Baltic states (Latvia, Lithuania and Estonia). Each of these programs aims to encourage scientists to reuse and recover

raw materials from industrial waste to obtain materials used in concrete-like products. The program will also focus on recovery of several metals and substances from wastewater, to use in construction, energy and water management<sup>138</sup>.



## 6

# National and regional regulatory framework

## Policy schemes

To boost the Latvian construction sector and increase its productivity and competitiveness, the Ministry of Economics and the Latvian Construction Council (*Latvijas Būvniecības Padomes*) approved the **Latvian Construction Industry Development Strategy for 2017-2024** (*Latvijas būvniecības nozares attīstības stratēģija 2017. – 2024. gadam*) in April 2017<sup>139</sup>. The main purpose of the strategy is to establish a common policy for the development of a sustainable and competitive construction industry in Latvia. To achieve this vision, several sector-specific strategic goals are defined:

- reduce construction bureaucracy and decrease the overall duration of the construction process by 50.0% via digital solutions;
- achieve a threefold increase in productivity in the sector and therefore rank among the top 10 EU Member States;
- increase the turnover of the construction sector from the current EUR 1.5 billion per year to EUR 3.0 billion per year;
- improve the system of education and professional qualifications of construction specialists, ensuring the availability of a highly qualified workforce in each construction profession;
- improve the quality of construction services, whilst creating a common quality measurement system.

In order to increase the efficiency of construction processes, a number of strategies have been adopted. This includes a streamlined approach to shorten the building design process, reduced administrative burden, acceleration of approval process through assignment of clear-cut

responsibilities, as well as digital document circulation. With the introduction of a **Construction Design Documentation** (*Būvniecības ieceres dokumentācijas noformēšana*), specific guidelines for construction project documentation, electronic design, and implementation of digital construction ideas were established<sup>140</sup>.

The housing policy in Latvia is under the responsibility of the Ministry of Economics. The state-owned Development Finance Institution ALTUM oversees its implementation. It administers EU and national funding to provide several financial instruments (loans, grants, guarantees, etc.) for businesses and individuals. Namely, ALTUM offers support schemes for the purchase of dwellings and for energy focused renovation<sup>141</sup>.

**The Housing Guarantee Programme (*Mājokļu galvojumu programmu*), the main state-aided scheme supporting the purchase and/or construction and renovation of the first home, has supported more than 10,608 housing guarantees as of February 2019<sup>142</sup>.**

Initially launched in 2014, it provides guarantees on mortgages for families with at least one child who have a stable income but who do not have enough savings for an initial down payment. The amount of the guarantee depends on the number of dependent children. Families with one child are eligible for guarantees up to 10% of the value of the loan (and up to a maximum of EUR 10,000), whereas families with two children can benefit from a guarantee of 15% (up to EUR 15,000). The amount of the guarantee increases to 20% of the loan (up to EUR 20,000) for families with three or more children. Guarantees can be provided for house purchases/ construction and renovation

costs up to EUR 200,000. A one-off fee equal to 2.5% of the guarantee's amount applies<sup>143</sup>.

From March 2018, the program was expanded to include people under the age of 35 that have completed a vocational education programme, as well as persons with at least one dependent child under 24 years of age (as compared to the previous support limited to families with children under the age of 18)<sup>144</sup>.

**In June 2020, the Latvian government amended the state support program for the purchase of housing, by providing EUR 3.5 million to support large families with the purchase of housing<sup>145</sup>.**

In addition, **the Law on Assistance in Solving Apartment Matters** (*Par palīdzību dzīvokļa jautājumū risināšanā*) explains the principles of social housing and housing allowances for eligible beneficiaries. Namely, the types of assistance defined by the document include the provision of temporary living space, housing benefits to support the payment of rent and property management fees, as well as allowances for renovation and adaptation of dwellings<sup>146</sup>. These topics are under the remit of the local municipal governments, which are responsible for their budget allocation and implementation. Following the Law, Local authorities provide services to individuals consisting of renting out social housing, support in exchanging current dwelling for a bigger one, providing temporary accommodation, or providing a specialist housing support-service<sup>147</sup>. For instance, the Riga City Council offers eligible beneficiaries

(i.e. families with children, people with disabilities, etc.) housing benefits of up to EUR 4.27 per m<sup>2</sup> to cover a portion of the rent, management fees and other fees related to the use of the living space, based on their income<sup>148</sup>.

In addition, the municipality of Riga partially covers utility costs (e.g. 25.0% for heating and 50.0% for water and wastewater) and provides social housing at a rent of EUR 0.06 per m<sup>2</sup>, well below rental market prices<sup>149</sup>. Finally, the municipality offers a housing adaptation allowance for people with disabilities, enabling them to hire a construction company to carry out adaptation works to improve the accessibility of their residence. The amount of the allowance may not exceed EUR 2,134.3<sup>150</sup>.

## Building regulations

**Construction Law** (*Būvniecības likums*), initially introduced in 1995, defines the main provisions related to the procedures of the construction process, rights and responsibilities of parties involved, certification and licensing of construction participants, principles of construction supervision and control, as well liability and insurance, among others<sup>151</sup>.

To simplify the regulatory framework, reduce the administrative burden and thus accelerate and promote the construction of new buildings, a new Construction Law entered into force in 2014. This reduced the number of decisions involved in the construction process. After submitting a construction intention and building design, the second step directly entails the issuing of the building permit. Thus, the authorities no longer take three decisions (issuing the architecture and planning assignment, accepting the building design, issuing the construction permit), but only one (issuing the construction permit)<sup>152</sup>.

Moreover, the time allowed to the building authority to decide about issuing the permit is limited to one month. In addition, the revised legislation includes the obligation to inform the public about the planned construction works within five days of receiving the permit and regulates in greater detail the qualifications, certifications and responsibilities of the participants in the construction process<sup>153</sup>.

Additional amendments to the Construction Law were enforced in 2017, aiming to further reduce the administrative burden and increase the efficiency of the construction process. These amendments introduced more relaxed requirements for changing the construction plan. Namely, it will be easier to deviate from certain initial technical requirements, with the exception of mechanical strength and stability requirements, where deviation will not be possible. Changes in the location of the building, in the construction site and in the facade will also be allowed after their approval by the building board or the institution that carries out the building management. Conversely, changes to the main use of the building are not envisaged<sup>154</sup>.

Sustainability of the Industry and eradication of the shadow economy has long been a priority issue

on the agenda of both the government and relevant stakeholders. In this context, the electronic working time recording system (*elektroniskā darba laika uzskaites sistēma – EDLUS*), mandated for new civil engineering projects and for all types of new construction works which value exceed EUR 1.0 million<sup>155</sup>, was implemented via amendments to the Law on Taxes and Duties. The amendments require general contractors to implement and maintain the EDLUS at the construction site, as well as for the storage of data until they are transferred to a *Single State database*. EDLUS registers the data of workers and the time they spent on the construction site. Furthermore, following the amendments to the Law on Taxes and Duties of 2019, the threshold of EUR 1.0 million was reduced to EUR 350,000, as of 1<sup>st</sup> January 2020. Additionally, as of 1<sup>st</sup> February 2020, general contractors are required to transfer the collected EDLUS data on the previous month to the Single State database, which is unified electronic working time recording system data base - (*vienotā elektroniskā darba laika uzskaites datu bāze – VEDLUDB*) and integrated in the Construction Information System (BIS). In order to eradicate the shadow economy, the minimum sectoral wage was increased in 2019 through the General Agreement of the Construction Industry (herein after – General Agreement), which is an industry-driven initiative aiming to strengthen fair competition and mitigate labour shortages by setting the sectoral minimum wage. The latter amounts to 780 euros (819 euros for qualified workers) since November 2019. This is 81.0% higher than the statutory minimum wage in Latvia (EUR 430) and is positively affecting more than 30,000 employees.

In September 2018, an additional amendment to the Construction Law was undertaken to make all documentation required for the construction process fully digital through the introduction of the **Construction Information System** (*Būvniecības Informācijas Sistēma – BIS*). These changes to the Construction Act are due to come into force<sup>156</sup>.

**BIS is an electronic platform (in the form of a state information system) where information is circulated between the public administration, supervisory bodies and parties to the construction process<sup>157</sup>.**

BIS is expected to minimise the administrative burden through electronic harmonisation of construction documents. Moreover, it will also significantly reduce the time needed to complete a construction project and eliminate paperwork<sup>158</sup>.

Under the Construction Act, as of 1 January 2020, it will be mandatory for the construction authorities and institutions (that fulfil the functions of a construction authority) to run the administrative proceedings, make decisions and coordinate construction plans through the BIS platform. BIS allows the initiator of a construction process not only to authorise construction professionals within construction proceedings but also any other individual. This feature of BIS will allow developers of various sections of building design, construction contractors and – where appropriate – legal services to be involved in the construction process<sup>159</sup>.

In addition to the Construction Law, a variety of other laws and regulations make up the construction regulatory environment, governing topics such as planning, design preparation, design, construction product conformity, hygiene requirements, as well as special building regulations. Instances include the General Construction Regulations (*Vispārīgie būvnoteikumi*), Procedures for the Market Surveillance of Construction Products (*Būvizrādājumu tirgus uzraudzības kārtība*), Spatial Development Planning Law (*Teritorijas attīstības plānošanas likums*) and the Regional Development Law (*Reģionālās attīstības likums*), among others<sup>160</sup>.

## Insurance and liability related regulations

In Latvia, according to the Construction Law, contractors have the duty to insure their civil legal liability for the damage caused to the life, health or property of other construction or third parties, as well as to the environment, resulting from their actions or failure to act. Insurance can be taken out either on an annual basis - covering all construction sites and having to be renewed each year - or in relation to a specific construction site, remaining valid throughout the entire construction process<sup>161</sup>.

In the case of an annual liability insurance for all construction sites, the limit of the insurance should be at least 10.0% of the building contractor's annual turnover. Similarly, the limit of the insurance in the case of a specific construction project should be no less than 10.0% of the value of the contract<sup>162</sup>. The builder may also use other types of insurance, regarding the building or the construction process, in addition to the compulsory construction civil liability insurance<sup>163</sup>.

It is common to take out Contractor All Risk (CAR) insurance for medium and large projects, with the liability limit varying between 5.0-18.0% of the contract value, depending on the agreement. For large scale projects, 10.0%-15.0% of the contract value is retained by the client upon completion of the construction works for up to two years, in case defects arise. The amount is returned to the contractor if no such issues occur within that timeframe<sup>164</sup>.

## 7

# Current status and national strategies to meet Construction 2020 objectives

## TO 1 – Investment conditions and volumes

Total **investment by the broad construction sector**<sup>165</sup>, has been fluctuating since 2010 (Figure 10). Particularly, investment by the narrow construction sub-sector grew from EUR 88.2 million in 2010 to EUR 137.3 million in 2018<sup>166</sup>(+55.7%). Similarly, investment by the real estate activities sub-sector increased from EUR 717.9 million in 2010 to EUR 966.5 million in 2018 (+34.6%).

Total investment by the narrow construction sub-sector between 2010 and 2018

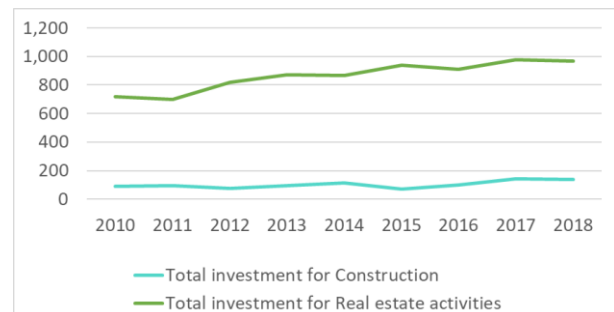
↑ 55.7%

Total investment by the real estate activities sub-sector between 2010 and 2018

↑ 34.6%

Similarly, **investment in intellectual property products** by the narrow construction sub-sector reached EUR 2.3 million in 2018<sup>167</sup> from EUR 0.9 million in 2010, marking a 155.6% increase over the period. Conversely, investment by the real estate activities sub-sector for this category declined by 293.1% during the same period, reaching EUR 11.2 million. Poor investment in intellectual property products in Latvia can be explained by a relatively weak digitalisation drive across economic sectors<sup>168</sup>.

Figure 9: Investment by the Latvian broad construction sector between 2010 and 2018<sup>169</sup> (EUR m)



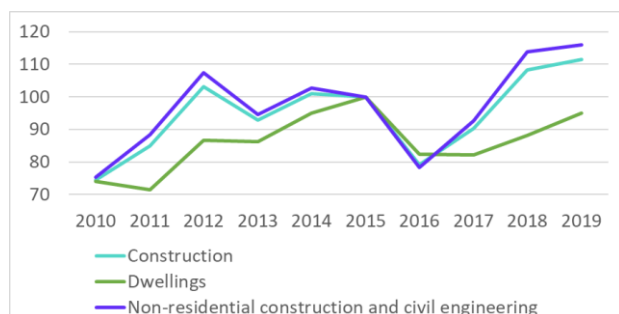
Source: Eurostat, 2020.

Total **investments index in the broad construction sector**<sup>170</sup> increased by 11.4% over the 2015-2019 period (Figure 11), primarily driven by the investments in non-residential construction and civil engineering, which experienced a growth of 15.8% over time. On the contrary, investments in dwellings registered a decline of 5.0% over the same reference period. In absolute terms, investments in the broad construction sector totalled EUR 2.8 billion in 2017<sup>171</sup>, out of which EUR 554.4 million were invested in dwellings and EUR 2.3 billion were devoted to non-residential and civil engineering<sup>172</sup>.

Total investment index in non-residential construction and civil engineering between 2015 and 2019

↑ 15.8%

Figure 10: Investment in the Latvian broad construction sector between 2010 and 2019 (2010=100)



Source: AMECO, 2020.

**Total inland infrastructure investment<sup>173</sup> as a share of GDP decreased from 1.1% in 2010 to 0.8% in 2018<sup>174</sup>, after recording the decade's high in 2015 (1.7%).**

**Investment in air transport infrastructure** registered a rise of 233.3%, rising from EUR 3.0 million in 2010 to EUR 10.0 million in 2018<sup>175</sup>. This was followed by a 69.0% rise in road infrastructure investment, which grew from EUR 131.0 million to EUR 221.4 million over time. Conversely, investment in railway infrastructure declined from EUR 73.0 million in 2010 to EUR 17.2 million in 2018 (-76.4%). Further, investment in road maintenance went up, from EUR 113.0 million to EUR 200.6 million, recording a 77.5% incline between 2010 and 2018. Similarly, investment in rail maintenance rose by 14.3% from EUR 98.0 million to EUR 112.0 million over the same reference period.

Air transport infrastructure investment between 2010 and 2018

↑ 233.3%

**From January to October 2020, the Latvian government invested EUR 5.8 million into maintenance of state roads, EUR 17.5 million into regional roads, EUR 32.3 million into maintenance of local roads<sup>176</sup>.**

In parallel, **household renovation spending** in Latvia increased by 50.3% over 2010-2018<sup>177</sup>, rising from EUR 38.6 million in 2010 to EUR 58.0 million in 2018. However, this is below the EU-27 average of EUR 72.1 billion. Moreover, **renovation spending as a share of total household disposable income** remained at par with the 2010 level of

0.3%, decently below the EU-27 average of 0.9% in 2018.

In 2019, investment growth in Latvia slowed down, putting an end of spurt, which saw a rise in investment of nearly 35.0% between 2016 and 2019. The growth was mainly driven by EU-funded public investment, supported by private sector investments in retail spaces and office buildings to accommodate the rapidly growing business and IT services industry<sup>178</sup>. In addition, 217.6 km of national roads were constructed, and an additional 58.1 km of regional roads were restored in 2019<sup>179</sup>. The total public financing for regional roads for 2016-2019 amounted to EUR 220.5 million, including the EUR 37.7 million received in 2019.

**During 2020, construction works will be completed on 58.7 kilometres of state regional roads, supported by EU funds. Also, until the end of 2020, a total of 335.7 kilometres of state regional roads are planned to be constructed<sup>180</sup>.**

In 2019, Latvia conducted several works for restoration of infrastructure objects such as repairs of railway tracks and repairs of railway crossings. *SJSC Latvijas dzelzceļš* (a state-owned company that provides public railway infrastructure), with the co-financing of the Cohesion Fund (CF), is implementing several infrastructure development projects, including projects for the modernisation of the most important railway hubs and railway passenger infrastructure modernisation projects<sup>181</sup>.

**Three agreements on co-financing of the Connecting Europe Facility (CEF) for the Rail Baltica project have been signed until 2020, resulting in the available funding in Latvia amounting to EUR 292.0 million<sup>182</sup>.**

The **Rail Baltica project** is expected to play a key role to integrating the Baltics with the core European rail network. The project which finally commenced in November 2020<sup>183</sup> is expected to be delayed and miss the initially planned completion date of 2025<sup>184</sup>.

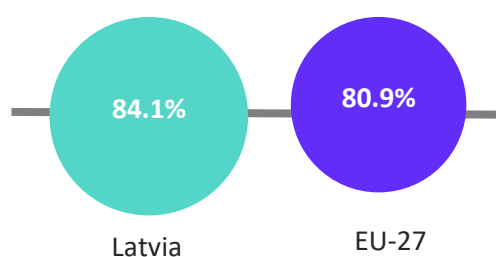
**In order to contribute to the country's economy, impacted by COVID-19, the ruling coalition in Latvia agreed in April 2020 to allocate EUR 75.0 million for road infrastructure projects. The amount will be used for mature projects that have lacked only funds until now<sup>185</sup>.**



## TO 2 – Skills

Latvia has taken several initiatives to strengthen the vocational education and training (VET) system. These include curriculum reform, development of education standards and qualifications, teacher training, work-based learning and apprenticeships. Despite these efforts, the **participation in upper secondary VET** stood at 38.8% in 2019, against the EU-27 average of 48.4%. Similarly, the **employment rate of recent VET graduates** in the country stood at 84.1% in 2019, above the EU-27 average of 80.9%<sup>186</sup>.

Employment rate of recent VET graduates, 2019



During 2019, Latvia supported the implementation of **work-based learning** through several projects. These projects consisted of cross-border mobility for VET students, continuous professional development for VET teachers and in-company trainers, and support to businesses in implementing work-based learning and practices<sup>187</sup>.

**By October 2019, 29 out of 38 VET schools and 469 companies in Latvia were implementing at least one work-based learning programme with 2,011 students participating**<sup>188</sup>.

Furthermore, **adult participation in learning** (aged 25-64) stood at 7.4% in 2019, below the EU-27 average of 10.8%<sup>189</sup>. Moreover, the **adult participation in learning for the low-skilled** was even lower, standing at only 2.5% in 2018<sup>190</sup>, against the EU-28<sup>191</sup> average of 4.3%. This is partially due to the low awareness and barriers in access. The main barriers to participation were the costs, conflict with working schedules or family responsibilities<sup>192</sup>.

The **Build Up Skills Latvia (Pillar I)** initiative contributes to enhancing the skill level of the

construction workforce, particularly with respect to energy efficiency in buildings. As part of the project, an action plan has been set up to identify the needs for training of the construction workforce. The objective of the programme is to increase the skills and knowledge of the construction workforce in order to meet the Europe 2020 goals on energy efficiency. To this purpose, the programme introduces a number of training sessions targeted at the development needs identified in a status quo analysis<sup>193</sup>.

The Latvian Builders Association is also active in strengthening the skills of the construction workforce. Notably, amongst the association's goals is the active participation in the development of the industry-specific vocational training system. Furthermore, the association is one of the partners of the Build Up Skills project and provides seminars on construction-related topics<sup>194</sup>.

**The Latvian Association of Civil Engineers provides a series of seminars to enhance the skills of its members, which cover a wide range of topics such as BIM, as well as regulatory aspects (construction law, procurement law, occupational health and safety, etc.)**<sup>195</sup>.

Latvia has increased its focus on providing innovation management courses from educational institutions. One such example being that of Riga Business School (RBS) offering mini-MBA program on Innovation Management. The program, meant for company executives, aims at creating innovation specialists with a focus on business. Participants in the program include construction companies such as *Pavasars Housing Construction*, among others<sup>196</sup>.

## TO 3 – Resource efficiency / Sustainable construction

In Latvia, the implementation of Energy Performance of Buildings Directives (EPBD) is the responsibility of the Ministry of Economics, which develops and implements the national energy efficiency policy<sup>197</sup>.

The current scheme **Increasing Energy Efficiency in Multi-Apartment Buildings 2014-2020** (*Energoefektivitātes pasākumi dzīvojamās ēkās: 2014-2020*), is aimed at promoting the renovation of multi-apartment buildings to improve their heat

insulation. The scheme offers owners financial aid for energy efficiency improvement measures of their multi-apartment residential buildings. Financial support is provided in the form of grants, guarantees and loans. Grant amounts vary between 36-50% of the value of the loan taken out from a commercial bank (or between 25-35% in case of a loan provided by ALTUM), depending on the final heating energy consumption achieved after the works<sup>198</sup>. Guarantees can cover up to 80.0% of a loan taken out from a financial institution, with the maximum guaranteed amount being set at EUR 3.0 million<sup>199</sup>. Loans can be provided by ALTUM in case no loans are available from other credit institutions, with their amount not exceeding the cost of the eligible energy efficiency measures<sup>200</sup>.

Activities supported by the scheme include renovation, reconstruction works, purchase and installation of high efficiency RE-based heat/hot water production equipment, etc. Upon completion of the renovation works, the annual heat energy consumption for heating must not exceed 90kWh/m<sup>2</sup><sup>201</sup>. The total budget of the programme is EUR 175.0 million over 2016-2023, of which EUR 150.0 million from the ERDF and EUR 25.0 million from the state budget<sup>202</sup>.

**As of January 2020, 881 project applications have been submitted within the support programme. The total ERDF funding requirement for these projects is expected to reach EUR 141.5 million.**

The implementation of 155 projects is completed, and 56 projects are still under construction to improve energy efficiency of residential buildings<sup>203</sup>.

**The ERDF financing for increasing energy efficiency of residential buildings stands at EUR 141.5 million, while for public buildings this amounts to EUR 94.6 million. In case of fulfilment of the performance framework, EUR 3.1 million is reserved<sup>204</sup>.**

The objective of energy efficiency measures for public (state and local government) buildings is to offer financial support to public building energy efficiency improvement projects. This will lead to an improvement in energy efficiency, smart energy management, use of renewable energy sources,

reduce greenhouse gas emissions (GHG), thus reducing municipal costs of heat supply.

**Under the energy efficiency improvement scheme, by March 2020, 129 project applications for the total funding of EUR 123.0 million from ERDF and state budget were approved<sup>205</sup>.**

Latvia currently has building stock of around 39,000 multifamily buildings with a floor area of around 55 million m<sup>2</sup>. The current average energy intensity of such multifamily buildings is around 160-180 kWh/m<sup>2</sup>, which is significantly higher than the 100 kWh/m<sup>2</sup> target of the **Latvian Energy Strategy 2030**<sup>206</sup>. In order to enable deep renovation of such buildings, a company called **Latvian Baltic Energy Efficiency Facility (LABEEF)** was set up in 2016.

**LABEEF aims to modernise around 20.0% of these building stocks by 2022, translating to annual avoided emissions of 21 kg CO<sub>2e</sub> per m<sub>2</sub>.**

LABEEF supports energy service companies (ESCOs) that implement renovation measures in multifamily buildings based on energy performance contracting (EPC). The ESCO finances a building's renovation measures through a commercial bank and makes an EPC contract with the building owners. Once the renovation is complete, the LABEEF monitors and verifies the effectiveness of these renovation measures. If satisfactory, the LABEEF will, in turn, forfeit the EPC contract and continue to collect EPC receivables from building owners, until the entire investment is collected. This enables a least risk position for the building owners, with the execution risk staying with ESCO and financing risk with that of LABEEF<sup>207</sup>.

Finally, the **'Let's live warmer' information campaign** (*Informēšanas kampaņa "Dzīvo siltāk"*), which was already introduced during the previous programming period continued<sup>208</sup>. In March 2020, a contest "Most Energy Efficient Building in Latvia 2020" under the 'Let's Live warmer' campaign was announced<sup>209</sup>.

## TO 4 – Single Market

**Latvia performed well with respect to the 2020 EU Single Market Scoreboard metrics, particularly in terms of Transposition of law, Internal Market Information System and Trade Integration in the Single Market for services<sup>210</sup>.**

With a transposition deficit of 0.3%, it has achieved its proposed target of 0.5% (EU-28<sup>211</sup> average stood at 0.6%). In fact, with half of the EU-28 average deficit, the country is among the member states with the best score. The average delay now stands at 7.4 months, which is below the EU-28 average of 11.5 months. Latvia now has only three overdue directives and none more than two years overdue, compared to the eight that were last reported. Conformity deficit increased from 0.6% to 0.8%, compared to the EU-28 average of 1.2%. In terms of Infringements, Latvia reported 17 pending cases as compared to EU-28 average of 29 cases. The average case duration also reduced to 25.7 months (EU-28 average 34.8 months) from 26.1 months previously reported<sup>212</sup>.

Latvia performed moderately well in terms of Internal Market Information System, with four out of five indicators standing above the EEA average. Similarly, its trade integration for goods is well above the EU-28<sup>213</sup> average, while trade integration for services stands only slightly above the EU-28 average.

**Even though the use of e-commerce and e-business is increasing, the percentage of SMEs intra-EU online exporters remains below the average with a share of 4.7%<sup>214</sup>.**

In addition, its performance in Public Procurement is positive, with 10 out of 12 indicators showing satisfactory results. However, its score in terms of the single bidder (i.e. the proportion of contracts awarded with only one bidder) was unsatisfactory and an average performance was noticed in no calls for bids (i.e. the proportion of procurement procedures negotiated with a company without a call for tender)<sup>215</sup>. Further, more than a third of Latvian companies believe that corruption has prevented them from winning a public tender. Inter alia, unclear evaluation criteria, collusive bidding, tailor-made specifications for companies are other risk factors commonly identified by companies<sup>216</sup>.

Recently, the Corruption Prevention and Combating Bureau (KNAB) raided several major construction companies as part of large-scale cartel investigations. The KNAB suspects involvement of at least 10 big construction companies of indulging in unfair trade practices such as agreeing prices in state procurements and bribing state officials. The officials, in turn, are suspected of accepting the bribes ranging from EUR 25,000.0 to several hundred thousand euros<sup>217</sup>. According to the KNAB, the legislative environment in the construction sector makes it particularly prone to ambiguity, misinterpretation and corruption, due to the complex, often overlapping and contradictory laws and regulations. Bribery is therefore often seen as a way to speed up the issuing of building permits and obtain preferential treatment<sup>218</sup>.

**In an effort to tackle the inefficiency and transparency issues existing in procurement procedures, the Procurement Supervision Bureau is planning to publish information on low-value procurement, as well as on the real value of contracts (versus the initial ones) in their electronic procurement system<sup>219</sup>.**

Additionally, in response to the corruption issue, the government is taking several steps, including the adoption of the **Guidelines for Prevention and Combating Corruption for 2015-2020** (*Korupcijas novēršanas un apkarošanas pamatnostādnes 2015-2020*). One of the main priorities of the guidelines is the evaluation of the risk of corruption arising from laws and regulations governing construction procedures and housing policies and to develop proposals for the necessary changes in the legislative framework<sup>220</sup>.

Moreover, the development of **Construction Information System (BIS)** was completed, with a cost of EUR 3.8 million<sup>221</sup>.

**BIS an online platform providing access to all construction documentation and relevant information, enabling effective communication between construction parties and keeping the public informed as to the latest construction decisions<sup>222</sup>.**

Finally, with respect to the implementation of **Eurocodes**, all Parts are published as National Standards, with 48 parts translated in the national language. The use of the Eurocodes is voluntary

and National Regulations are used in parallel with EN 1990, EN 1991, EN 1992, EN 1995 and EN 1996 (except for EN 1994). Further, no National Annexes are published on 13 Eurocodes Parts and even the published ones are not available in English. Moreover, there is no regulatory framework that enforces the use of Eurocodes in public procurement<sup>223</sup>.

## TO 5 – International competitiveness

Latvia ranks 41<sup>st</sup> out of 141 economies in the 2019 Global Competitiveness Index<sup>224</sup>, an improvement compared to last year (42<sup>nd</sup> out of 140 economies).

Per the report, the country ranks 65<sup>th</sup> out of 141 economies in trade openness. It performs specifically well in trade tariffs (7<sup>th</sup>) and prevalence of non-tariff barriers (19<sup>th</sup>). However, it ranks 50<sup>th</sup> in border clearance efficiency and 113<sup>th</sup> in complexity of tariffs.

The **internalisation of construction products** in the Latvian construction sector has been consistently showing signs of growth since 2010. **The export values of all construction-related products** increased from EUR 591.6 million in 2010 to EUR 1.5 billion in 2019, marking an increase of 148.2% over time. Moreover, Latvia's share of exports of all construction-related products stood at 109.1% of the total value of production in 2018, below the 2010 level of 178.4% and above the EU-27 average of 11.4%. This further improved a bit to reach 111.1% in 2019.

Export value of all construction-related products between 2010 and 2019

 **148.2%**

In the context of **inward FATS (Foreign affiliates statistics)**<sup>225</sup>, value added at factor cost and turnover in the manufacturing sub-sector increased by 84.2% and 84.7% between 2010 and 2017<sup>226</sup>. Similarly, in terms of number of persons employed, it experienced an increase of 35.4% over time. In the narrow construction sub-sector, value added at factor cost and turnover registered growth of 103.1% and 82.1% respectively, over the same reference period. The number of persons employed in the sub-sector also grew by 57.2%

between 2010 and 2017. This trend of consistent growth in the value added at factor cost and turnover was also witnessed in the real estate activities sub-sector, which rose by 101.0% and 125.4% over time, respectively. Similarly, there was a 90.9% incline in the number of persons employed in the real estate activities sub-sector during the same reference period.

According to the SBA Fact Sheet report 2019, Latvia performs in line with the EU-28<sup>227</sup> average in terms of internationalisation. The country performs particularly well in areas of information availability, advance rulings and formalities – automation<sup>228</sup>.

As per the report, Latvia is the third worst performer in border agency cooperation. Despite remaining below the EU-28<sup>229</sup> average, the share of SMEs engaging in extra-EU online exports increased in 2015-2017<sup>230</sup>.

The Latvian government launched the **'International promotion of competitiveness'** programme to support SME activities to enter foreign markets. Also, a one-stop-shop to access export support services is managed by Latvian Investment and Development Agency (LIDA). The agency also operates representative offices in foreign markets to ensuring strong links to major business partners and locations<sup>231</sup>.

Trade missions are organised by the **Investment and Development Agency of Latvia** (*Latvijas Investīciju un attīstības aģentūra* – LIAA) and the **Latvian Chamber of Commerce and Industry**. For instance, in 2018, construction trade missions to Sweden and Denmark took place<sup>232</sup>. 10 Latvian construction companies also participated in *'Nordbygg 2018'*, Scandinavia's largest construction industry trade fair, during which participants obtained business contacts, such as future cooperation business agreements<sup>233</sup>.

Typical obstacles faced by Latvian construction companies wishing to operate abroad includes insolvency of foreign customers, late or non-payments as well as fluctuations in economic and political contexts of third countries, which can result in significant losses<sup>234</sup>. To this end, ALTUM offers both short-term and long-term **Export Credit Guarantees** (*Eksporta kredīta garantiju programme*), protecting exporters against the commercial as well as political risks. Precisely, the

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export credit guarantee covers up to 90.0% of the value of the export transaction in the case of commercial risks, and up to 95.0% for political risks. Moreover, the guarantee covers late payments of up to two years, and its value can

amount up to EUR 2.0 million<sup>235</sup>. Guarantees are provided only for exports to third countries (excluding the EU, EEA, USA and other industrialised countries), such as all African, Asian, and South American states<sup>236</sup>.



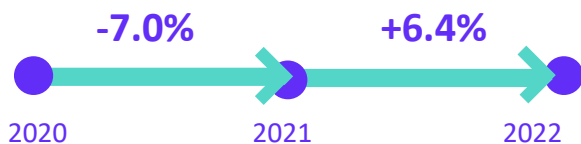
## 8

# Outlook

The Latvian economy is expected to decline in 2020 due to the COVID-19 pandemic that triggered a countrywide lockdown and the ensuing slump in economic activities. Nevertheless, the economy is expected to experience growth again in 2021.

Latvia's GDP is projected to decrease by 7.0% in 2020 and then rise by 6.4% in 2021, amounting to EUR 27.2 billion in 2021.

Expected GDP growth between 2020-2022



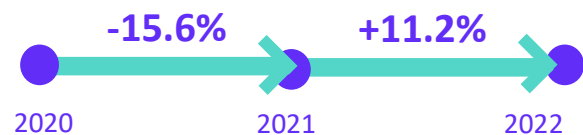
Similarly, the **volume index of production** in the broad construction sector is expected to decline by 12.9 ip annually in 2020, mainly due to a 17.7 ip and 10.9 ip declines in the construction of buildings and the construction of civil engineering in 2020, respectively. Conversely, the volume index of production in the broad construction sector is further expected to grow by 8.9 ip annually in 2021.

In turn, the **turnover** in the broad construction sector is forecasted to decline by 14.7% in 2020 and then grow again by 15.3% in 2021, reaching EUR 9.1 billion. Similarly, the **total value added** of the broad construction sector is expected to decrease by 15.2% in 2020 and then increase by 13.4% in 2021, reaching EUR 2.5 billion in 2021.

Following the same trend, the number of **persons employed** in the broad construction sector is

expected to decrease by 15.6% to 122,719 in 2020 and then increase by 11.2% to 136,499 in 2021. This decline is projected to come from the all the sub-sectors including the real estate activities (-22.2%), the manufacturing (-17.6%), the narrow construction (-13.0%), and the architectural and engineering activities (-12.7%) sub-sectors in 2020.

Number of persons employed in the broad construction sector between 2020 and 2022



The housing market in Latvia is slowly growing with average apartment prices (particularly in the Riga region) rising. Moreover, in June 2020, the Latvian government amended the state support program for the purchase of housing, by providing EUR 3.5 million to support large families for the purchase of housing. This is expected to drive the growth in the Latvian housing market.

In terms of civil engineering, investment is projected to slow down as inflows of EU funds reach their peak in 2020. Nevertheless, construction related to the Rail *Baltica* project, which started in November 2020, is expected to boost construction activity and investment in 2021.

The outlook for the Latvian construction sector remains positive. The ruling government's decision to infuse EUR 75.0 million for road infrastructure projects is expected to contribute to the growth of broad construction sector.



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