LATVIA

- The gap in GDP per capita with respect to most advanced OECD countries remains large, reflecting a large productivity gap. Convergence in productivity is progressing but is slower than before the global economic crisis. Growth in labour utilisation has improved recently despite the emigration of youth, who tend to have a high labour participation rate.
- Income inequality is still among the highest in OECD countries but has declined somewhat recently. The income share of the poor has risen, albeit from a low level.
- Regarding past *Going for Growth* recommendations, the labour tax wedge on low-income earners has been reduced somewhat, which could encourage formal employment. However, progress is slow and is not associated with a much needed rebalancing of revenue sources from labour income taxes to property or environment-related taxes. Reforms of higher education and research are resulting in a consolidation of research institutions, quality-based financing models and incentives to boost research. Improving the R&D innovation framework is therefore no longer considered a *Going for Growth* priority.
- Further reducing the labour tax wedge, better targeting social benefits to poor households and boosting active labour market policies would increase employment and reduce the high poverty rate. Strengthening vocational training would ease skills shortages that are constraining productivity growth. Further reducing red tape, administrative burden and state involvement in business operations will spur entrepreneurship and investment, inducing a more robust productivity convergence.
- Aligning taxation of energy sources with their carbon content and abolishing subsidies on environmentally harmful activities would make room to lower the tax wedge, but also reduce Latvia's high energy consumption and greenhouse gas emissions.

Going for Growth 2017 priorities

Strengthen vocational education.[1] Skill shortages are constraining employment and productivity growth.

Recommendations: Proceed with the reform of vocational education and training to increase the quality and relevance of skills. Expand work-placed learning by integrating the existing apprenticeship system in the formal education system and by establishing a legal framework regulating the relationship between employer and apprentices. Consider providing incentives to small firms providing work-placed learning. Encourage lifelong learning by improving information about training opportunities. Provide more support for minorities to acquire skills. Streamline policy responsibility for vocational schools and adult learning.

Reduce labour tax wedges and improve the efficiency of the tax system. The high labour tax wedge for low-income earners results in structural unemployment and informal employment and encourages emigration, while widespread tax evasion reduces the room for public expenditure to reduce poverty.

Actions taken: The personal income tax rate was reduced from 24% to 23% in 2015. The basic labour income tax allowance for those earning around the minimum wage will be gradually increased between 2016 and 2020. Taxes on CO_2 and small particle emissions

1. New policy priorities identified in *Going for Growth 2017* (with respect to *Going for Growth 2015*) are preceded and followed by an "*".

LATVIA

Growth performance and inequality indicators

A. Growth

Average annual growth rates (%)		2003-09	2009-15
GDP per capita		4.5	3.7
Labour utilisation		-0.1	1.7
of which:	Labour force participation rate	1.1	0.3
	Employment rate[1]	-1.1	1.5
	Employment coefficient[2]	0.0	-0.1
Labour productivity		4.4	2.6
of which:	Capital deepening	3.4	0.6
	Total factor productivity	0.9	2.1
Dependency ratio		0.2	-0.7

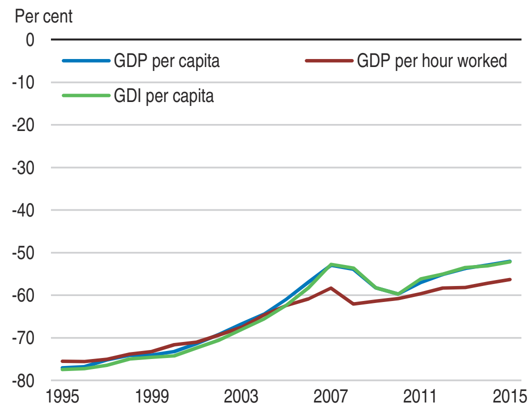
B. Inequality

	Level	Annual variation (percentage points)
	2013	2008-13
Gini coefficient[3]	35.2 (31.7)*	-0.4 (0)*
Share of national disposable income held by the poorest 20%	6.6 (7.7)*	0.1 (0)*

* *OECD average*

C. Convergence in GDP per capita has resumed

Gap to the upper half of OECD countries[4]



1. The employment rate is defined with respect to the economically active population; a positive growth rate corresponds to a decline in the structural unemployment rate and vice-versa.
2. This adjustment variable is added to the decomposition to capture the impact of non-resident workers.
3. The Gini index measures the extent to which the distribution of disposable income among households deviates from perfect equal distribution. A value of zero represents perfect equality and a value of 100 extreme inequality.
4. Percentage gap with respect to the weighted average using population weights of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2010 PPPs).

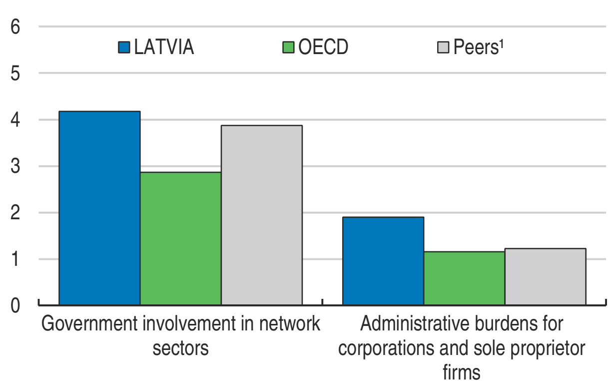
Source: Panel A: OECD, *Economic Outlook No. 100 Database*; Panel B: OECD, *Income Distribution Database*; Panel C: OECD, *National Accounts and Productivity Databases*.

StatLink http://dx.doi.org/10.1787/888933455170

Policy indicators

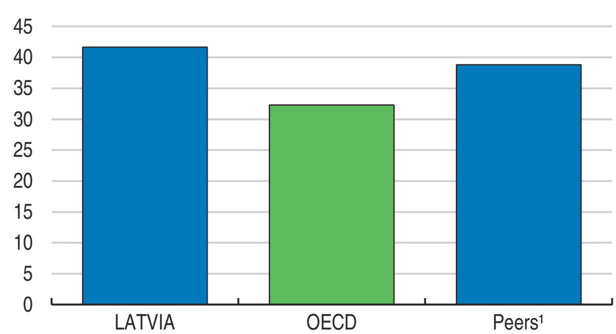
A. State ownership is widespread and the regulatory burden is high

Index scale of 0-6 from least to most restrictive, 2013



B. Low-income earners face comparatively high labour tax wedge

Percentage of total labour compensation,[2] 2015



1. Average of the Czech Republic, Estonia, the Slovak Republic and Slovenia.
2. Labour taxes include personal income tax and employee plus employer social security contributions and any payroll tax less cash transfers. Single person at 67% of average earnings without children.

Source: Panel A: OECD, *Product Market Regulation Database*; Panel B: OECD, *Taxing wages Database*.

StatLink http://dx.doi.org/10.1787/888933455639

LATVIA

were increased in 2015. Tax allowances for the purchase and operating costs of company cars were reduced in 2016.

Recommendations: Further reduce the labour tax wedge for low-income earners. Increase revenue from property taxes. Align energy tax rates with the carbon content of energy sources and phase out environmentally harmful subsidies. Continue to strengthen revenue collection by simplifying tax compliance and allocating more resources to tax collection.

Strengthen social protection. Social benefits are low and not targeted to the poor. High long-term unemployment contributes to poverty. High out-of-pocket payments limit access to healthcare especially for the poor.

Actions taken: Individualised support for the long-term unemployed that include health assessment, consultation and career development was introduced in 2016. Additional spending (0.3% of GDP) to improve access to healthcare services has been included in the 2017 Budget.

Recommendations: Step up and target social benefits more strongly toward low-income households. Improve incentives for low-income workers to take-up a job by withdrawing benefits gradually. Raise government spending on active labour market policies (ALMPs). Improve collaboration between the public employment services and the municipalities which pay benefits to the long-term unemployed. Consider covering the cost of health services for vulnerable and low-income groups in full. Make the contracts of the National Health Service with providers more performance-driven.

Reduce regulatory burdens and state involvement in the economy. Red tape weighs on businesses and the large weight of State-owned Enterprises (SOEs) hinders competition and resource allocation, thereby slowing productivity growth.

Actions taken: Legislation implemented in 2015 reintroduced supervisory and management boards to the biggest SOEs, required annual reporting and established an entity co-ordinating the management of state-owned enterprises.

Recommendations: Strengthen financial and administrative independence of the Competition Council. Further improve corporate governance of all state-owned enterprises in line with the OECD Guidelines on Corporate Governance of State-Owned Enterprises. Ensure a level-playing field for incumbents and market entrants in network industries. Simplify the permits and licences system and reduce the complexity of regulatory procedures. Reduce regulatory barriers to entry for pharmacies and abolish compulsory chamber membership in professional services.

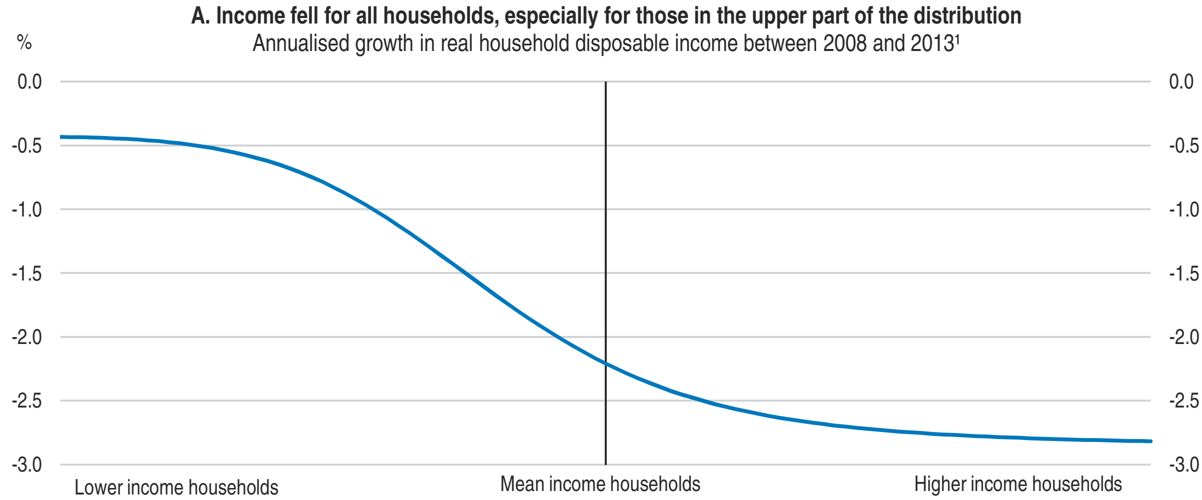
Strengthen infrastructure. Energy, road and port infrastructure are underdeveloped, isolating Latvia from the EU electricity markets and constraining productivity growth and regional development.

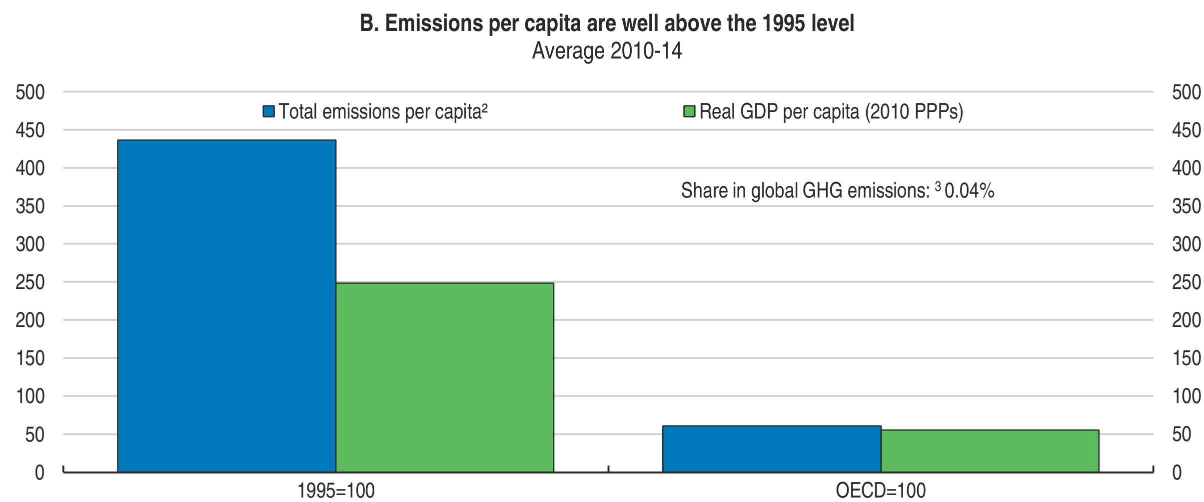
Actions taken: A Memorandum of Understanding was signed on June 2015 which includes synchronisation of the electricity grid with the European networks by 2025. An agreement on the first stage of the high-speed railway construction project which will connect Baltic countries to European networks was signed in 2015.

Recommendations: Further increase the connectivity to EU electric network. Enhance the quality of transport infrastructure, especially on roads. Promote port efficiency, including by enhancing management transparency and facilitating private investment.

LATVIA

Beyond GDP per capita: Other policy objectives





1. The data show average annual growth rates in disposable income (i.e. income after tax and transfers) across the distribution and refer to the period between 2008 and 2013. Disposable incomes cover the full population. Income data are expressed in constant prices (OECD base year 2010).
2. Total GHG emissions including LULUCF in CO_2 equivalents (UNFCCC). The OECD average (excluding Israel and Korea) is calculated according to the same definition.
3. Share in world GHG emissions is calculated using International Energy Agency (IEA) 2010 data.

Source: Panel A: OECD, *Income Distribution Database*; Panel B: OECD, *National Accounts and Energy (IEA) Databases*, *United Nations Framework Convention on Climate Change (UNFCCC) Database*.

StatLink http://dx.doi.org/10.1787/888933456090