2017 OECD ECONOMIC SURVEY OF LATVIA

Boosting productivity and inclusiveness

September 15th 2017, Riga Latvia

Main messages

• The Latvian economy is growing strongly, underpinned by progress with economic reforms.

• Deeper integration into international trade is necessary to catch up with high-income countries.

• Poverty and unemployment are still high. Access to jobs, housing and health services need to improve.
Growth has been strong

Real GDP, Index 2007 = 100

Exports have gained market share

Export performance indicator, moving average 2010=100

Unemployment has fallen

Unemployment rate as % of labour force

Wages have grown more than prices

Growth of labour compensation per employee and consumer price inflation

Latvia is a top reformer

The 2017 Going for Growth reform responsiveness indicator

Debt has fallen

Debt as % of GDP

Important challenges remain
The gap in productivity remains large

Gap in GDP per capita of Latvia vis-à-vis the upper half of OECD countries

Poverty is high

Share of population with disposable income below the poverty line, 2015 or latest

Income inequality remains high

Gini coefficient, scale from 0 (perfect equality) to 1 (perfect inequality), 2015 or latest available

Higher income, better housing and better health would raise wellbeing

OECD Better Life Index, from 0 (worse) to 1 (best), 2016

Credit growth is still weak

Year-on-year percentage change of credit stock

Source: Bank of Latvia.
Seize opportunities in global markets to catch up with high-income countries
Productivity growth has slowed

Average annual growth of labour productivity

Trade could boost productivity and income

Domestic value added per worker embodied in foreign final demand, 2011

Latvia must move up the value chain to knowledge-intensive activities

Many workers feel under-skilled at the time of hiring

Share of employees reporting lower skill level than required for their jobs at the time of hiring, 2014

Skill shortages are holding back participation in global value chains

Share of employees reporting lower skill level than required for their current jobs, 2014

Few firms cooperate with research institutions

The share of firms engaging in research cooperation
% of all product and/or process-innovating firms, 2012-14

Low debt recovery hampers access to credit

Average recovery rate from insolvency, 2016

Infrastructure lags behind peer countries

Global Competitiveness Index, scale from 1 to 7 (best) 2016-17

Recommendations to seize opportunities in global markets to catch up with high-income countries

- Provide more generous grants for students attending vocational schools who are from low-income families.
- Expand grants for university students and target them to students from low-income families.
- Increase government funding of innovation promotion programmes with strong evaluation results.
- Strengthen the specialisation of judges to improve the insolvency regime.
- Apply the same cost-benefit tests to large national infrastructure projects as are applied to EU-funded projects.
Improving access to jobs, housing, and health services
Unemployment is high in some regions

Unemployment as % of the labour force, 2016

Source: Central Statistical Bureau of Latvia.
High unemployment keeps poverty high

Share of population with disposable income below 60% of median household income

Source: Central Statistical Bureau of Latvia.
Access to affordable rental housing is low

Share of rental housing, low-income households, 2014 or latest year

Source: OECD (2016), OECD Affordable Housing Database.
Spending on active labour market policies is low

Public expenditure, % of GDP, 2015 or most recent

Out-of-pocket payments in healthcare are high

Household out-of-pocket expenditure, % of total current expenditure on health care, 2015

Source: OECD (2017), OECD Health Statistics (database)
Workers pay high fees for private pensions

Operating costs of the private pension system
% of assets under management, 2015

Recommendations to improve access to jobs, housing, and health services

- Expand the mobility programme, which provides temporary support for relocation and transport to unemployed moving to a job.
- Provide more funding for low-cost rented housing in areas of expanding employment.
- Improve legal certainty in rental regulation and encourage out-of-court procedures.
- Simplify the administrative process for obtaining a building permit.
- Promote the provision of adult education by vocational education schools.
- Lower operating costs in the compulsory private pension system, for example by introducing a low-cost fund as the default choice.
- Reduce health care out-of-pocket payments especially for the low-income population.
Using budget and tax policy to support inclusive growth
Government debt is low

General government debt % of GDP, 2016

Informality remains high

Estimated size of the shadow economy and underreported corporate profits and wages, 2016

Taxes on low wages are high

Taxation of labour income, 2016
% of total labour compensation, single person at 67% of average earnings without children

➢ Tax reform approved in 2017 will reduce taxes on profits and wages from 2018.

Source: OECD (2017), OECD Tax Statistics (database) and OECD estimate of tax reform effect.
Recommendations for budget and tax policy to support inclusive growth

- Raise spending to address pressing structural and social policy priorities.
- Make better use of information and communication technology for tax law enforcement.
- Strengthen the budgetary independence of the Corruption Prevention and Combating Bureau (KNAB).
- Remove political influence in the appointment of judges.
- Reduce taxes on low wages further.
- Raise more revenues from the taxation of real estate and energy.
- Broaden the base of business income taxation by removing tax exemptions.
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