



# European Construction Sector Observatory

Country profile **Latvia**

January 2020



## In a nutshell

The **Latvian GDP** grew by 4.8% during 2018, the highest GDP growth rate since 2010. The growth was driven by consumer spending and strong investment levels supported by EU fund inflows. The **construction sector** has generally been recovering since 2010, although it experienced additional contractions in 2015 and 2016.

The **volume index of production** in the broad construction sector increased by 20.6% between 2015 and 2018 after witnessing a major year-on-year (YoY) decline of 16.6% in 2016. Following the increase in production, the **turnover** of the sector amounted to EUR 9.1 billion in 2018<sup>1</sup>, 92.9% above the bottom low of 2010. As a result, **employment** and the number of enterprises in the broad construction sector increased by 51.8% and 67.8% respectively between 2010 and 2018.

Number of enterprises  
in the broad  
construction sector  
between 2010 and  
2018

↑ 67.8%

Turnover growth of the  
broad construction  
sector between 2010  
and 2018

↑ 92.9%

The **housing market** has been on the revival path since 2010, supported by declining mortgage rates (from 3.7% in 2010 to 2.2% in 2018) and greater household purchasing power. This is also reflected by the **house price index** for total dwellings, which increased by 29.3% between 2015 and 2018, equating to 49.0 index points increase from 2010. This trend is partly driven by the house price index

for new existing dwellings, which rose by 30.2% over the 2010-2018 period. In 2018, 1,925 building permits were issued for the construction of new one-dwelling buildings and 1,273 permits for construction, capital repairs reconstruction and restoration of existing one-dwelling houses<sup>2</sup>. The demand for housing has been boosted by introduction of the Housing Guarantee Programme, providing guarantees on mortgages to support the purchase and/or construction and renovation of the first home. The programme also enables families and young professionals get a mortgage against lower down payment than banks would normally require.

House price index for  
total dwellings  
between 2010 and  
2018 (index points)

↑ 49.0

Investment priorities for the development and modernisation of Latvia's **transport infrastructure**, particularly roads and railways, are defined in the **Latvian National Development Plan 2014-2020**, the **Transport Development Guidelines 2014-2020** and the **National Roads Programme 2014-2020**.

While the quality of transport infrastructure in Latvia has improved significantly, the quality of road infrastructure remains well below EU-28 average. Accordingly, Latvia's 2019 budgetary plan dedicated a total of EUR 236.1 million towards road construction and maintenance<sup>3</sup>. Currently Latvia also lags behind in the completion of the major **Rail Baltica project** and that of the conventional TEN-T rail core network, leading to an extension of the deadline of completion of the project to 2026. Additionally, the agencies estimate an additional

investment of around EUR 1.67 billion for completion of the project in Latvia<sup>4</sup>.

In terms of workforce, the Latvian construction sector is facing a shortage of skilled workers, especially construction managers, water and wastewater engineers and roofers. Additionally, persisting corruption risks in the Latvian construction sector act as a barrier to its development. Last, delays in the absorption of EU funds and the deferral and concentration of large infrastructure projects over 2018-2020 may increase risks of a construction “bubble”. This may

in turn lead to price increases and affect quality of the construction works.

**The outlook for Latvian construction sector is positive in the short to medium term, driven by EU fund inflows and domestic consumption. However, the sector faces challenges in terms of availability of skilled workforce and lack of effective implementation of various projects. The country’s over-reliance on EU funds, informal employment, and lack of access to finance continue to act as a deterrent for potential new investors.**

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## 1

## Key figures

## Construction market

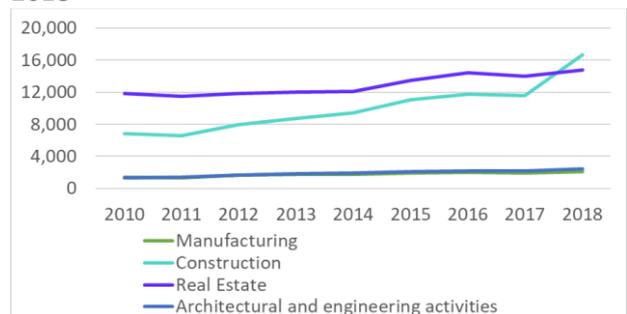
The **number of enterprises** in the broad construction sector in Latvia totalled 36,008 in 2018<sup>5</sup> (Figure 1), with the real estate and narrow construction subsectors accounting for 41.1% and 46.3% respectively of the total number of companies in the broad construction sector. Overall, the number of enterprises in the broad construction sector increased by 67.8% between 2010 and 2018, led by the narrow construction (+142.3%) and architectural and engineering activities (+84.7%).

Number of enterprises in the broad construction sector between 2010 and 2018

↑ 67.8%

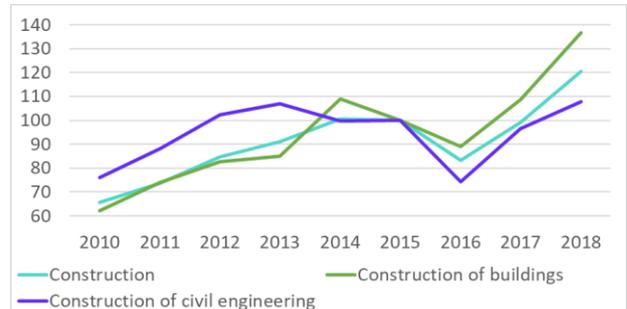
The **volume index of production** of the broad construction sector increased by 54.8 index points between 2010 and 2018, after a major decline in 2016 (Figure 2). This decline was partly explained by the drop of production in the civil engineering sub-sector, itself linked to the slower absorption of EU funds<sup>6</sup>. The corresponding increase between 2015 and 2018 amounted to 20.6%. In addition, production in construction of buildings grew in 2018, at a level 36.7% higher than in 2015, (and 74.5 index points higher than the 2010 levels). Last, production in civil engineering, on the other hand, increased by 7.8% in 2018 compared to 2015, reaching a level 31.8 index points higher than in 2010.

Figure 1: Number of enterprises in the broad construction sector in Latvia between 2010 and 2018



Source: Eurostat, 2019.

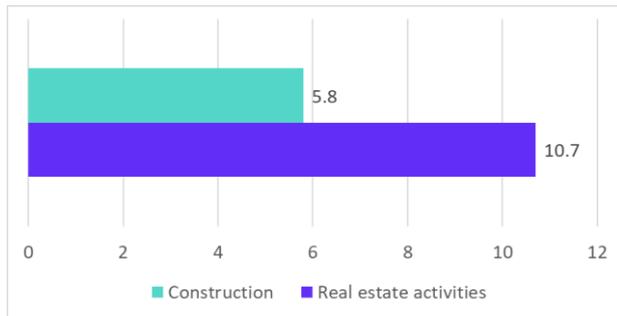
Figure 2: Volume index of production in the Latvian broad construction sector between 2010 and 2018 (2015=100)



Source: Eurostat, 2019.

The total **added value at factor cost** of the broad construction sector amounted to EUR 2.6 billion in 2018<sup>7</sup>, with the narrow construction sub-sector contributing to 48.2% of the total<sup>8</sup> (EUR 1.3 billion), followed by real estate activities, manufacturing and architectural and engineering activities sub sectors. The **share of gross value added** of the real estate activities and narrow construction sub-sectors in the GDP reached 10.7% and 5.8% in 2018.

Figure 3: Gross value added as a share of GDP in the Latvian broad construction sector in 2018<sup>9</sup> (%)



Source: Eurostat, 2019.

## Productivity

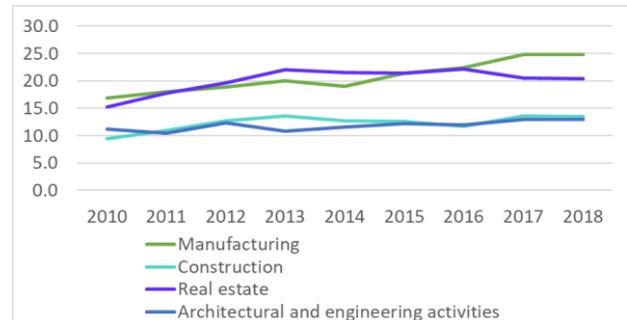
The **apparent labour productivity**<sup>10</sup> in the broad construction sector has been experiencing an increasing trend, growing from EUR 12,300 in 2010 to EUR 17,100 in 2017<sup>11</sup> (+38.9%).

In fact, all sub-sectors experienced an apparent labour productivity increase between 2010 and 2018 (Figure 4). The manufacturing sub-sector reported the highest productivity increase (+46.9%), from EUR 16,900 in 2010 to EUR 24,800 in 2018<sup>12</sup>. This was followed by the real estate activities sub-sector, which experienced a productivity growth of 34.4% over the same time period. It went from EUR 15,200 to EUR 20,500. Architectural and engineering activities reported the lowest productivity increase (+15.8%), which grew from EUR 11,200 to EUR 13,000 between 2010 and 2018<sup>13</sup>.

Apparent labour productivity in the narrow construction sub-sector between 2010 and 2018

↑ 41.6%

Figure 4: Labour productivity in the broad construction sector in Latvia between 2010 and 2018 (EUR k)



Source: Eurostat, 2019.

## Turnover and profitability

The total **turnover** of the broad construction sector amounted to EUR 7.3 billion in 2017, a 54.4% above the 2010 levels (EUR 4.7 billion). It further expected reached EUR 9.1 billion in 2018. The narrow construction sub-sector accounted for 59.8% of the total, followed by manufacturing (20.6%), real estate activities (16.8%) and architectural and engineering activities (2.8%). The turnover in broad construction sector is expected to sustain its momentum and grow in the coming years.

Total turnover of the broad construction sector between 2010 and 2018

↑ 92.9%

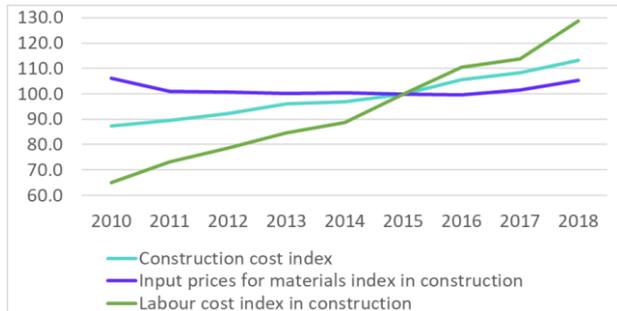
Similarly, the **gross operating surplus** of the broad construction sector increased from EUR 710.9 million in 2010 to EUR 1.1 billion in 2017<sup>14</sup> (+48.8%).

The **gross operating rate** of the broad construction sector<sup>15</sup>, which gives an indication of the sector's profitability, stood at 14.5% in 2017, which is slightly lower than in 2010 (15.0%). The gross operating rate also witnessed a YoY decrease by 1.3 basis points in comparison to 2016. The real estate activities sub-sector reported the highest gross operating rate of 31.2%, followed by manufacturing (15.3%), and architectural and engineering services (14.7%). The narrow construction sub-sector has been the least profitable with a gross operating rate of 7.9% in 2017.

The decreasing profitability could be partially explained by rising **construction costs**. In fact, the construction cost index increased by 25.9 index

points between 2010 and 2018. More specifically, it grew by 13.2% increase between 2015 and 2018, mainly driven by a 28.8% increase in labour cost during the same period. The input prices for materials, too, increased, albeit at a slower rate of 5.3% between 2015 and 2018 (Figure 5).

Figure 5: Construction cost index between 2010 and 2018 (2015=100)



Source: Eurostat, 2019.

## Employment

In 2018<sup>16</sup>, 159,281 persons were employed in the broad construction sector, a 51.8% increase compared to 2010 (104,894) but lower than the pre-crisis levels (154,367 in 2008). Specifically, the narrow construction sub-sector employed 59.1% of the total construction workforce in 2018 (94,158 people) – being a 77.8% increase compared to 2010 (52,954). The real estate activities sub-sector, though accounting for the second largest share of employed people (21.1% or 33,639), reported a relatively slower growth (8.6%) between 2010 and 2018. The manufacturing and architectural and engineering activities sub-sectors witnessed strong growth of 51.1% and 47.9%, to reach 22,503 and 8,981 employees by 2018, respectively (Figure 6).

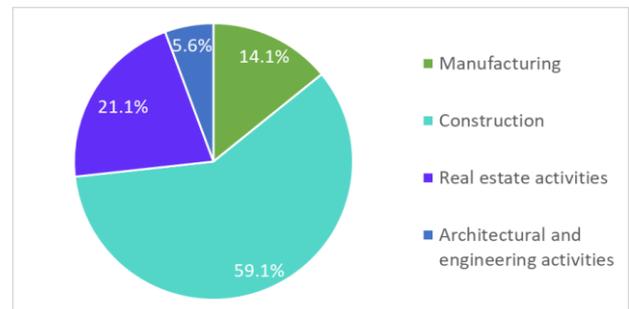
Number of persons employed in the broad construction sector between 2010 and 2018

↑ 51.8%

As for **employment by specific occupation**, the number of technicians and associate professionals in the narrow construction sub-sector increased by 68.4% between 2010 and 2018, the highest

occupational increase among sub-sectors. Meanwhile, the craft and related trades workers, the largest occupation in both the manufacturing and narrow construction sub-sectors, recorded respective increases of 16.8% and 29.8% during the same period. Likewise, the number of workers involved in elementary occupations increased by 12.3% and 48.8% in the above two sub-sectors. Conversely, workers involved in elementary occupations in real estate activities decreased by 7.0%. The number of managers also declined by 26.5% and 11.8% respectively in the manufacturing and narrow construction sub-sectors between 2010 and 2018. They increased by 30.4% in the real estate activities sub-sector over the same period.

Figure 6: Percentage of persons employed by broad construction sub-sectors in Latvia in 2018



Source: Eurostat, 2019.

The number of **self-employed** workers in the narrow construction sub-sector increased from 6,600 in 2010 to 9,400 in 2018 (+42.4%), representing 9.8% of the self-employed in the general economy. This is below the EU-28<sup>17</sup> average of 13.1%. Self-employed workers in the real estate activities stood at a similar level than 2013<sup>18</sup>, after it reached 3,700 in 2017. The real estate activities sub-sector's share of self employed in the general economy stood at 2.6% in 2018, which is significantly above the EU-28 average of 1.3%. In 2017, SMEs employed 90.1% of the total workforce in the broad construction sector. In 2016, the number was at 89.6%, above the EU-28 average of 85.5%, highlighting the importance of SMEs in construction employment in Latvia.

## 2

# Macroeconomic indicators

## Economic development

Latvia's economy has been on the recovery path since 2011, with its GDP amounting to EUR 23.9 billion in 2018, 11.9% higher than 2015 and 33.0% above the 2010 level.

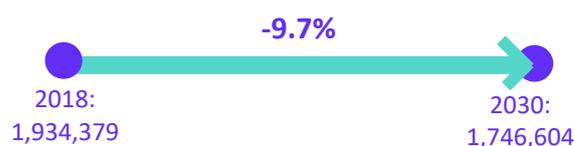
Economic growth in Latvia is catching at a fast pace with the EU-28 average, driven by strong investment recovery and strong consumer spending<sup>19</sup>. In 2018, the potential GDP was EUR 23.2 billion, resulting in a positive output gap (2.8%, compared to 1.7% in 2017 and -12.5% in 2010). This shows that resources are slightly overworked. The **inflation rate** has been fluctuating since 2010, peaking at 4.2% in 2011 and subsequently declining to 2.6% in 2018.

## Demography and employment

In terms of demographics, Latvia's **total population** reached 1.9 million people in 2018, but is projected to decline to 1.7 million by 2030 (-9.7%) and to 1.6 million by 2050 (-18.1%). In parallel, net migration has been negative since 2000, standing at -4,905 in 2018 – which is however less than the 2010 level of -35,640 (indicating increasing immigration, which is not enough to mitigate emigration of especially young Lithuanian).

In parallel, Latvia's **working age population**, which made up 53.1% of the total in 2018, is expected to shrink to 40.4% by 2050. At the same time, people aged 65 or older will make up 28.7% of the total population in 2050, as compared to 20.1% in 2018. Taken together, emigration and the ageing population will constitute a challenge for labour supply and for the social security and health systems.

Latvia's total population forecast



The **unemployment rate** reached 7.4% in 2018, above the EU-28 average of 6.8% but well below the 2010 level (19.5%)<sup>20</sup>. Youth unemployment (below the age of 25) stood at 12.2% in 2018, below the EU-28 average of 15.2%, and on a decreasing path since the 2010 peak (36.2%).

## Public finance

In 2018, general **government expenditure** in Latvia accounted for 38.5% of GDP, a decline of 6.8 percentage points since 2010 (45.3%). The same year, general **government deficit** stood at -0.7% of GDP, owing to increased defence and healthcare spending and a sizeable tax cut<sup>21</sup>. General **government gross debt** accounted for 36.4% of GDP, below the 2010 level of 47.3%, and is projected to further decline over the coming years<sup>22</sup>.

## Entrepreneurship and access to finance

According to the 2019-2020 Global Competitiveness Report, Latvia ranks 85<sup>th</sup> out of 141 economies in terms of financial system, with banks' regulatory capital ratio being the best performing indicator (31<sup>st</sup>), followed by venture capital availability and financing of SMEs, ranked 48<sup>th</sup> and 55<sup>th</sup>, respectively<sup>23</sup>.

Conversely, credit gap scores comparably worse (134<sup>th</sup>) followed by market capitalisation (111<sup>th</sup>) and insurance premium (91<sup>st</sup>)<sup>24</sup>. Indeed, **outstanding loans** to non-financial corporations dropped from EUR 8.9 billion in 2010 to EUR 5.6 billion in 2018 (-37.2%).

According to the 2019 Survey on the Access to Finance of Enterprises (SAFE) report, 42% of SMEs in Latvia consider bank loans as a relevant form of financing (as compared to 45% EU-28 average). 21% of SMEs applied for a loan (compared to 24% at EU-28 level), while 6% did not apply as they feared the application would get rejected (compared to 4% at EU-28 level)<sup>25</sup>.

Latvia ranked 26<sup>th</sup> out of 190 economies in terms of **starting a business**, requiring four procedures and 5.5 days to register a firm<sup>26</sup>

**Latvia continues to perform above the EU-28 average for early stage entrepreneurial activity. Particularly for women, established business ownership, entrepreneurship education and entrepreneurship intentions.**

Indeed, the country introduced a few important policies in the entrepreneurship domain that have promoted a favourable environment for

entrepreneurs and start-ups. Latvia aims at attracting and supporting the creation of start-ups in its territory. To achieve this goal, the Ministry of Economics released planned activities for 2018 including: i) an open representation in Silicon Valley; (ii) facilitating entrepreneurs' participation in the acceleration process; (iii) further regulation to support FinTech development; (iv) facilitating cooperation between universities and businesses; (v) expanding support for R&D. In 2019, Latvia initiated one key measure named **'Support for start-ups - changes in procedures for applying and administering aid'** (*Atbalsts jaunuzņēmumiem - izmaiņas pieteikšanās noteikumos un administrēšanā*). The key changes were to relax the application criteria for start-ups and increased period of venture capital (VC) investments from 12 months to 24 months. Additionally, start-ups with VC investments of at least EUR 150,000 may now apply for two consecutive periods of support<sup>27</sup>.

## 3

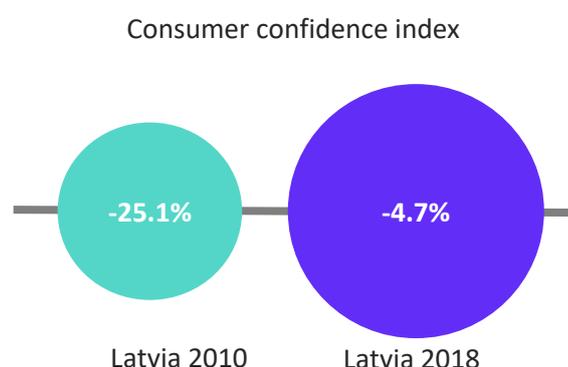
# Key economic drivers of the construction sector

## Business confidence

Latvia's confidence indicators, though mostly in negative territory, have largely improved over the 2010-2018 period.

The **consumer confidence index** stood at -4.7 in 2018, considerably better than 2010 (-25.1) and in line with the EU-28 average of -4.7. Similarly, the **industry confidence indicator** was at 1.6 in 2018, well above the 2010 levels of -7.6, but below the EU-28 average of 6.0. The **construction confidence index**, which has been in deep negative territory since 2008, improved considerably, reaching at -1.0 in 2018 (as compared to -49.6 in 2010). It is however, below the EU-28 average of 4.1.

Reflecting these improvements, the **investment ratio** has been increasing from 19.4% in 2010 to 23.3% in 2018. Likewise, **investment per worker** has been increasing from EUR 15,650 in 2010 to EUR 18,930 in 2017.



## Domestic sales

The ranking of the **most domestically sold construction products** in Latvia has remained relatively constant since 2010. That said, “doors, windows and their frames” experienced a 447.5% increase of the value of domestic sales. This increase may be explained by the Latvian government schemes (which are in some instances supported by EU funds) aiming to support the (energy-efficient) renovation of dwellings. This was followed by a 413.0% increase for “prefabricated buildings of metal” between 2010 and 2018. The top 5 most domestically sold construction products are presented in Table 1, including a comparison with the most sold in the EU-28. These represented 67.6% of total domestic construction product sales in 2018.

Table 1: 5 most domestically sold construction products in Latvia and in the EU in 2018

Latvia				EU-28
	Product	Value (EUR m)	Share in construction product domestic sales (%)	Product
1	Prefabricated buildings of metal (group 251110)	58.0	15.1	Other structures (group 251123)
2	Other plywood, etc. (group 162118)	55.9	14.5	Doors, windows and their frames (group 251210)
3	Ready-mixed concrete (group 236310)	54.2	14.1	Ready mixed concrete (group 236310)
4	Doors, windows and their frames, etc. (group 251210)	52.6	13.7	Prefabricated buildings of metal (group 251110)

Latvia				EU-28
	Product	Value (EUR m)	Share in construction product domestic sales (%)	Product
5	Windows, French windows and their frames, etc. (group 162311)	39.4	10.2	Prefabricated structural components (group 236112)

Source: PRODCOM, 2019.

## Export of construction-related products and services

The ranking of the **most exported construction products** has remained relatively stable since 2010. Notably, “prefabricated structural components for building or civil engineering, of cement, concrete or artificial stone” saw an increase of 1,315.8% of value of exports, followed by a 110.0% increase of “pallets, box pallets and other load boards of wood” between 2010 and 2018. The top 5 most exported construction products from Latvia and the EU-28 are summarised in Table 2. Together, these made up 58.8% of all construction products exports in 2018.

Table 2: 5 most exported construction products in Latvia and in the EU in 2017

Latvia				EU-28
	Product	Value (EUR m)	Share in construction product export sales (%)	Product
1	Other plywood, veneered panels and similar laminated wood (group 162118)	267.2	18.8	Ceramic tiles and flags (group 233110)
2	Pellets and briquettes, of pressed and agglomerated wood (group 162915)	221.4	15.6	Other structures (group 251123)
3	Oriented strand board (OSB) (group 162113)	149.9	10.6	Marble, travertine, alabaster, worked, and articles thereof (group 237011)
4	Pallets, box pallets and other load	103.1	7.3	Prefabricated buildings of metal

Latvia				EU-28
	Product	Value (EUR m)	Share in construction product export sales (%)	Product
	boards of wood (group 162411)			(group 251110)
5	Prefabricated structural components (group 236112)	92.9	6.5	Doors, windows, etc. (group 251210)

Source: PRODCOM, 2019.

In terms of **cross-border provision of construction services**<sup>28</sup>, Latvia **exported** EUR 264.0 million worldwide in 2018, of which EUR 248.0 million went to the EU-28. This represents a considerable increase of 347.5% compared to the 2010 level of EUR 59 million. In comparison, Latvia **imported** a total of EUR 59.0 million in construction services in 2018, a 18.0% increase from EUR 50 million in 2010. Of the total imports in 2018, EUR 55.0 million came from the EU-28. Latvia therefore achieved a **trade surplus** of EUR 205 million in 2018. This represents a significant improvement (+2,177.8%) as compared to a trade surplus of EUR 9 million in 2010, predominantly driven by an increase in exports<sup>29</sup>.

## 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 industry has been declining continuously since 2010. **Outstanding loans** to the narrow construction sub-sector have fallen from EUR 991.5 million in 2010 to EUR 152.5 million in 2018 (-84.6%).

**Latvian construction firms report a relatively lower share (22%) of external financing in their funding structure, as compared to a 30% cross-sectoral country average. Infrastructure firms, on the other hand, have the highest share of external finance (36%).**

Leasing is a major source of external finance for 48% of construction firms in Latvia. Bank loans and other bank finance are other key sources of finance. Non-institutional loans are a source of finance for less than 10% of construction firms in Latvia<sup>30</sup>.

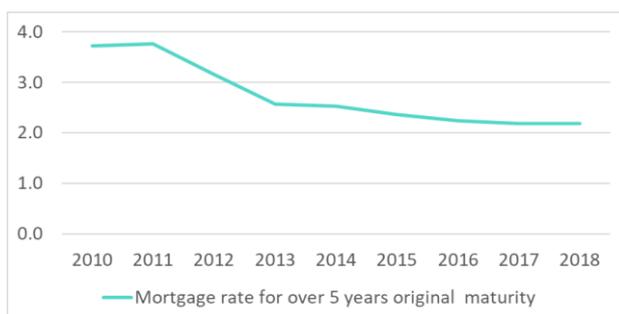
Additionally, Latvia's state-owned development institution, ALTUM, has signed a microfinance guarantee agreement with EIF under the EU Programme for Employment and Social Innovation (EaSI). Through the agreement ALTUM will provide EUR 15 million loans to 600 micro-businesses between 2018 and 2021. The scheme, which primarily targets start-ups and small businesses will provide these loans at relatively lower interest rates and collateral requirements<sup>31</sup>.

## Access to housing

The number of households in Latvia increased from 809,100 in 2010 to 854,400 in 2018 (+5.6%). The share of total population living in cities and greater cities stood at 43.4% in 2018, 8.2 percentage points above the 2009<sup>32</sup> level (35.3%). This may indicate an increasing pressure for housing in urban areas, especially in primary cities. In parallel, the **mean equivalised net income** increased from EUR 5,466 in 2010 to EUR 8,738 in 2018 (+59.9%).

In parallel, the **interest rates** on mortgages have been declining from 3.7% in 2010 to 2.2% in 2018 (Figure 7). Nevertheless, **outstanding residential loans** to households decreased from EUR 6.6 billion in 2010 to EUR 4.1 billion in 2018 (-37.5%), possibly linked to the growing house prices.

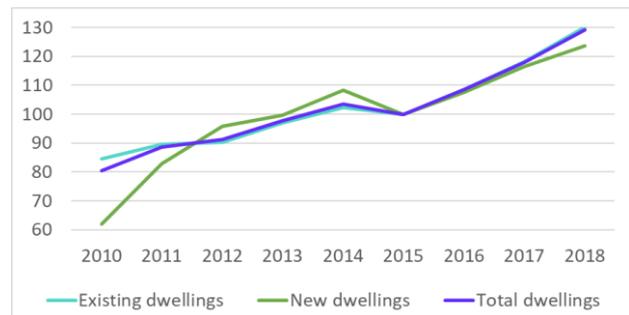
Figure 7: Mortgage rates for loans over 5 years original maturity (%)



Source: European Central Bank, 2019.

House prices have been picking up since 2010, signalling the recovery of the housing market after the burst of the housing bubble. Indeed, the **house price index** for total dwellings increased by 29.3% between 2015 and 2018. This trend is partly driven by the house price index for existing dwellings, which rose by 30.2% over the same period (Figure 8).

Figure 8: House price index in Latvia between 2010 and 2018 (2015=100)



Source: Eurostat, 2019.

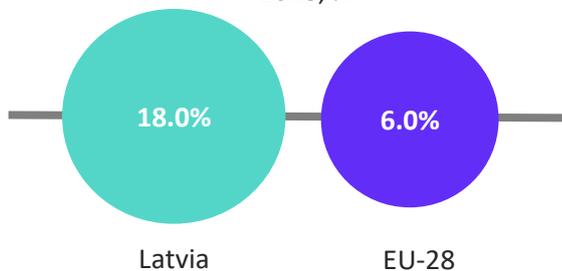
The developments in the housing market have been supported by an increasing demand for properties over the past few years, with a consistent increase in number of transactions in housing projects (although not supported by the increase in the mortgages). Riga's house price rises are now gradually slowing, amidst limited supply<sup>33</sup>. Dwellings completions in Latvia increased slightly in 2017. In Riga, a total of 1,458 apartments were constructed in 2017 - 16% more than in the previous year<sup>34</sup>. However, outside Riga, prices continue to rise rapidly. An important driver of the strong demand is the five-year Latvian residence permit granted to foreigners upon purchase of residential properties, as stipulated under the Immigration Law amendments of 2010. Since the launch of this scheme in 2010, demand for properties from foreign buyers, particularly from Russia, China and other former Soviet countries has been rising, especially in cities such as Riga and Jurmala. It is estimated that foreigners now account for 70% of all property transactions in the country. However, amendments to the Immigration Law in 2014 introduced other conditions and costs for obtaining a residence under the programme. This in turn reduced the (foreign) housing demand and negatively affected the increase in house prices in 2015<sup>35</sup>.

On the supply front, 2,966 new dwellings were completed in 2018. This marks a 54.2% increment relative to 2010 (1,924 dwellings completed). While this represents a steep increase (30.6%) from 2,271 in 2017, it is still 68.2% below the 9,319-peak reported in 2007<sup>36</sup>.

Finally, Latvia reports a high **home ownership** rate, standing at 81.6% in 2018. However, it has been declining since the 2010 level of 84.3%<sup>37</sup>. Moreover, the **housing cost overburden rate**<sup>38</sup> was at 6.7% in

2018, below the EU-28 average of 10.4% and the lowest value since 2010<sup>39</sup>. Conversely, the **overcrowding rate**<sup>40</sup> stood at 41.9% in 2017<sup>41</sup>, well above the EU-28 average of 15.7%<sup>42</sup>, while the **severe housing deprivation rate**<sup>43</sup>, reached 18.0% in 2018, higher than the EU-28 average of 6.0%<sup>44</sup>. This indicates challenges with respect to overall housing quality and stresses the need for social housing. The latter made up only 0.4% of the housing stock in the country in 2015<sup>45</sup>. The availability of social housing is scarce and waiting lists are long, especially in Riga<sup>46</sup>. Following this, the European Commission through the European Semester recommended Latvia for the first time in 2019 to focus investment specifically on affordable and social housing<sup>47</sup>.

Severe housing deprivation rate in Latvia, 2018, %



## Infrastructure

Latvia ranks 43<sup>rd</sup> out of 141 economies in terms of its infrastructure, according to the 2019-2020 Global Competitiveness Report.

In particular, it performs well with respect to the efficiency of train services (21<sup>st</sup>), efficiency of air transport services (15<sup>th</sup>) and road connectivity (27<sup>th</sup>). Furthermore, it shows good performance regarding the railroad density (30<sup>th</sup>) and efficiency of seaport services (34<sup>th</sup>). In contrast, the quality of its road infrastructure scores poorly (95<sup>th</sup>)<sup>48</sup>. Indeed, Latvia ranks third last EU Member States in terms of the quality of road infrastructure, after Romania and Malta. This is an important obstacle to road safety. In fact, Latvia recorded one of the highest fatality rates at 70 deaths per million inhabitants in 2017 (EU-28 average is 49). Conversely, the country scores above the EU average in terms of completion of the TEN-T Core Road Network, with 100% of it being complete<sup>49</sup>.

## 4

## Key issues and barriers in the construction sector

### Company failure

The business demography in the broad construction sector has consistently seen higher number of company births as compared to the number of deaths between 2010 and 2017.

**Company births** in the narrow construction sub-sector increased from 1,352 in 2010 to 1,864 in 2017 (+37.9%), whereas the number of **company deaths** decreased from 1,081 to 652 (-39.7%). The real estate activities sub-sector, however, experienced a decrease in both the company births (-10.9% from 1,425 in 2010 to 1,269 in 2017) and deaths (-68.6% from 1,301 to 409). Company births in architectural and engineering activities increased from 151 to 221 between 2010 and 2017 (+46.4%), whereas company deaths went down from 99 to 83 (-16.2%).

The number of corporate insolvencies in Latvia has slightly increased from 587 in 2017 to 591 in 2018<sup>50</sup>. This is however, much below the highs of 2,407 in 2010<sup>51</sup>. The construction sector accounted for over 20% of the total insolvencies in 2016<sup>52</sup>.

### Trade credit

According to the 2019 Survey on the SAFE, 16.0% of surveyed SMEs consider that trade credit is a relevant source of finance for them. This is well below when the EU-28 average of 31.0%<sup>53</sup>. In addition, only 8.0% of total respondents had used this source of finance during the six months prior the survey, lower than the EU-28 average (17.0%). At the same time, over 16.8% of respondents believe the availability of trade credit will increase revealing an increased willingness of companies to use trade credit.

### Late payment

Late payments are less of a concern among Latvian businesses as compared to the EU-28 average<sup>54</sup>.

In Latvia, a mere 28.0% of businesses face issues with debtors paying after due date. This is considerably lower, than the EU-28 average of around 50.0% in 2019. Likewise, around 14.0% of Latvian companies face credit loss related issues, which is low in comparison to the 46.0% EU-28 average<sup>55</sup>.

In 2019, the average contractual payment terms allowed in business-to-business (B2B) transactions was 18 days, whereas payment terms for public administration-to-business transactions (PA2B) averaged 10 days. This is less than in 2018 (20 days and 22 days, respectively). The respective EU-28 averages for 2019 stood at 34 days and 33 days in 2019. In addition, the average payment time for settlement of invoices of B2B and PA2B transactions stood at 20 days and 14 days in 2019. This, too, is significantly lower than the respective EU-28 averages of 40 days and 42 days. Debtors in financial difficulty is flagged as the main cause of late payments by 43% of the respondents<sup>56</sup>.

### Time and cost of obtaining building permits and licenses

Latvia ranks 56<sup>th</sup> with respect to “Dealing with construction permits”, according to the World Bank Doing Business 2020<sup>57</sup>.

Completing the formalities to build a warehouse<sup>58</sup>, requires 14 procedures, higher than the OECD high-income average of 12.7, and takes 192 days,

compared to the OECD high-income average of 152.3 (Table 3). However, the cost of completing the formalities to build a warehouse only represents 0.4% of the value of the warehouse, well below the OECD high-income average of 1.5%. In particular, requesting and obtaining the building permit takes 30 days and costs EUR 1,409.

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 grew from 600 in 2010 to 2,249 in 2018.**

Vacancies in the real estate sub-sector increased from 99 in 2010 to 305 in 2018. **Adult participation in education and training** in the narrow construction sub-sector has generally been fluctuating over the past years, declining from 5.8%

in 2010 to 4.2% in 2018. In the real estate activities, adult participation in education and training stood at 10.0% in 2017<sup>59</sup>. The **number of tertiary students** in engineering, manufacturing and construction, specifically in architecture and building, have been experiencing a sharp decline, dropping from 949 in 2010 to 544 in 2017 (-42.7%). The number, however, reported the decade's first YoY increase from 446 in 2016 (22.0%). These indicators show that the broad construction sector suffers from labour (and skills) shortage.

Low and medium-skilled workers can switch between specialisations, depending on the available job offers, owing to the fact that 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>60</sup>. Indeed, the major gaps in terms of 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% of their work<sup>61</sup>. Moreover, the low wages offered and the seasonality of the industry make job prospects in the sector unstable and unattractive. This has led the most qualified workers to leave the country to find opportunities abroad. Thus, about 1,000 workers leave the industry every year, but only a few hundred new ones enter the profession. Therefore, the Latvian construction sector suffers from a shortage of qualified workers, especially construction managers, water and wastewater engineers and roofers<sup>62</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% 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 construction sector has increased in 2019, indicating a severe shortage of manpower across skillsets<sup>63</sup>.

## Sector and sub-sector specific issues

### Material efficiency and waste management

In 2012<sup>64</sup>, Latvia reported a total amount of 396,955 tonnes of construction and demolition (C&D) waste, out of which 155,323 were recycled. This represents a 159.4% increase of C&D waste compared to the amount reported in 2010 (153,000 tonnes). However, data availability and reliability in Latvia are an issue, and therefore this increase should be interpreted carefully<sup>65</sup>. In 2016, construction activities generated a total waste of 111,133 tonnes in Latvia. This was 415.7% greater than the waste generated in 2010, 21,551 tonnes<sup>66</sup>.

Waste management, including C&D waste, is governed by the **Waste Management Law** of 2010<sup>67</sup>. It establishes general requirements and procedures for waste management and prevention. In addition, the **Natural Resources Tax Law**<sup>68</sup> imposes mandatory fees to “high polluters” in order to encourage pollution reduction and waste management implementation.

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>69</sup>.

**The National Waste Management Plan 2013-2020<sup>70</sup> set up good practices and objectives to prevent waste generation and reducing the volumes of waste up to 2020.**

The plan has established several targets, including reducing the flow of waste going to landfill by increasing recycling by 50% to 80% depending on the type of waste. Moreover, a 70% recycling rate for construction and demolition waste should be reached by 2020.

### Climate and energy

**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 227,281 tonnes and 113,491 tonnes in 2018, respectively. Emissions in the narrow construction sub-sector have declined by 1.0% during the period 2010-2018, whereas emissions in the real estate sub-sector have declined by 7.2% during the same period<sup>71</sup>.

## 5

# Innovation in the construction sector

## Innovation performance

Latvia is considered as a Moderate Innovator, according to the European Innovation Scoreboard 2019<sup>72</sup>.

The country has experienced a strong performance improvement, with its innovation score reaching 60 in 2018, relative to EU in 2018. The relative strengths of the Latvian innovation system lie in Innovation-friendly environment, Finance and support, and Employment impacts. The country performs below the EU average for most dimensions, such as Innovators, Attractive research systems, and Firm investments.

In the broad construction sector, **business enterprise R&D expenditure (BERD)** in the professional, scientific and technical activities sub-sector<sup>73</sup> experienced a generally increasing trend, despite some fluctuations (Figure 9). It increased from EUR 6.1 million in 2010 to EUR 10.1 million in 2014 (+66.4%)<sup>74</sup>. BERD in the narrow construction sub-sector attained a level of EUR 0.3 million in 2015<sup>75</sup>.

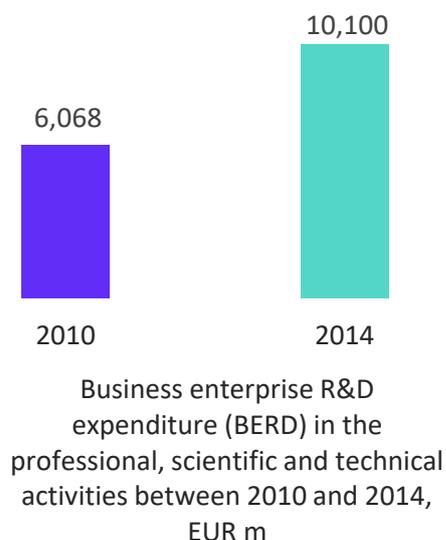
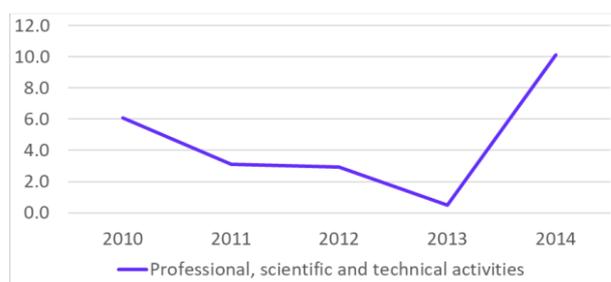


Figure 9: Business enterprise R&D expenditure (BERD) per construction sub-sectors in Latvia (EUR m)



Source: Eurostat, 2019.

The total **R&D personnel** (full-time equivalents – FTE)<sup>76</sup> in the professional, scientific and technical activities sub-sector declined from 313 in 2010 to 72 in 2016 (-77.0%). Similarly, FTE in the narrow construction sub-sector declined from 10 in 2010 to only 7 in 2016<sup>77</sup>, demonstrating the low levels of private sector engagement in R&D in the Latvian construction sector.

Latvia is the second last EU Member State in terms of R&D funding as a percentage of GDP. As of 2017, it stood at 0.51%, well below the targeted level of 1.1%<sup>78</sup>.

Low R&D investments, while having a negative effect on long term growth, will limit possibilities of developing knowledge and technology-intensive industries and reaching higher productivity<sup>79</sup>.

Moreover, the limited innovative capacity of Latvian construction companies is suggested by the low number of construction-related patent applications registered. In fact, only 5 construction-related patents have been registered in Latvia between 2010 and 2018. In addition, no Latvian Construction & Materials firm ranks within the top 1,000 EU companies by R&D (industrial sector ICB-3D), according to the 2019 EU R&D Scoreboard<sup>80</sup>.

## Eco-innovation and digitalisation

According to the Eco-Innovation Scoreboard 2018, Latvia is ranked as a country catching up with an overall index of 82 relative to the EU-28 average of 100<sup>81</sup>.

Nevertheless, the country has seen the rise of innovative companies active in sustainable construction and digitalisation (see more details below). Indeed, the Ministry of Economics has started organising the **Startup Ecosystem Forum**, which connects Latvian start-ups with academic sectors, non-governmental organisations as well as large and state-owned companies on a single platform. The event, in addition to promoting cross-sector collaboration and greater contribution from Latvian start-ups, aims to create a healthy environment for co-creation of world class innovations and new smart city technologies for the Baltic region. The 2019 event, for example, hosted key deliberations on innovation in healthcare, green technologies and smart cities<sup>82</sup>.

The Riga City Council has implemented a grant programme called **Take-Off** (*Atspēriens*), which, since 2009, has been promoting development of new, innovative companies in the Riga territory. The programme co-finances 80% of the various administrative expenses ranging from specific technical equipment and licences, fees, specific trainings, marketing materials, etc. Starting 2019, the programme has shifted focus to smart city solutions, with a maximum grant of EUR 25,000 per innovative idea in the field. In November 2019, the programme granted a total of EUR 75,000 for three companies—Evlab Ltd., ARConstruction Ltd. and Kong Ltd.—providing innovative smart city solutions. Evlab is an innovative bicycle sharing network based on the brand Nextbike Latvia. ARConstruction, on the other hand, will leverage the grant to create a prototype to develop a multi-storey parking system combined with electric charging stations. Kong Ltd aims to develop environment friendly transport in cities of Latvia and other countries, as well as to support the development of electric transport infrastructure<sup>83</sup>. The **Latvian Sustainable Construction Council** (*Ilgspējīgas būvniecības padome* – IBP) was established in 2010 to bring together construction industry professionals such as construction companies, material manufacturers, non-

governmental organisations and academics, with the aim of raising public awareness around sustainable construction and promote its applications and integration in the Latvian construction policy and practice<sup>84</sup>. The IBP is also a partner in the EU-funded project BUILD UPON, seeking to provide support to public institutions in developing and implementing national renovation strategies, according to EU legislation. The project plans to promote the development and implementation of a long-term energy-efficient renovation framework in 13 European countries and has a total budget of EUR 2.35 million<sup>85</sup>.

In 2019, The Riga Technical University, in partnership with two other Baltic universities, Kaunas University of Technology and Tallinn University of Technology, has established a knowledge and innovation contact point – EIT RawMaterials Baltic Hub. The Hub will address the shortage of, and focus on innovations in, raw materials in construction, energy and water management in Baltic states<sup>86</sup>.

The **EIT RawMaterials Baltic Hub** will implement three programs in succession in Latvia, Lithuania, and Estonia. The program encourages scientists to reuse and recover raw materials from industrial wastes such as electro filter ash, ceramic residue etc. and obtain alkali active materials used in concrete-like products. They will also focus on recovering various metals and substances from wastewater, to use in construction, energy and water management. Interest is also there in the broader use of wood, for example, in the development of innovative composite materials for construction and other ecological materials<sup>87</sup>.

Furthermore, the Latvian government has devoted its efforts to the preparation of national programmes and strategies aiming to promote innovation across the different sectors of the national economy. As part of this endeavour, the **Smart Specialisation Strategy**<sup>88</sup> intends to foster the development of specialisation areas to support the growth priorities of the country. In particular, these priorities areas include the improvement of energy efficiency, the modernisation of the education system to match future labour market demands and the development of other key technologies, such as the use of advanced materials and manufacturing systems<sup>89</sup>. In this context, Latvia

received the support of Innovation Norway<sup>90</sup>, which has invested EUR 11.3 million in the country through the programme “**Green Industry Innovation**”. This programme aims to promote eco-innovation entrepreneurship and increase the competitiveness of green enterprises<sup>91</sup>.

**Adoption of digital technologies by firms in Latvia is lower than in the EU-28. 45% of Latvian firms, compared to 58% in EU-28, have implemented at-least one digital technology, either partially or fully. Similarly, only 7% of firms in Latvia, as compared to 11% in EU-28 organise their entire business around one or more digital technologies. There is specific focus on the internet-of-things (IoT), and cognitive technologies<sup>92</sup>.**

Specifically, in the construction sector, firms have been leveraging four key digital technologies, viz., IoT (adopted by 17% firms), drones (13%), 3-D printing (4%) and cognitive technologies (2%). The level of adoption of all these technologies is lower than that of EU-28 average where the respective adoption levels are 26%, 21%, 11% and 12%<sup>93</sup>.

A number of Latvian start-ups are focussing on digital and platform-based technologies. One of them, named Vartus, has developed a custom, artificial intelligence (AI) powered online tool that calculates the value of real estate. The tool applies machine learning algorithms on a variety of data sets such as public records and private data on real transactions to estimates apartment prices with a certain degree of accuracy<sup>94</sup>. In addition, a Latvian start-up has developed OROCON, a management system for construction companies which acts as a cooperation platform that simplifies the burden of supervising several projects at a time. This helps reduce the costs associated with the construction process and improve the effectiveness of project

management, thus increasing the safety of construction projects. OROCON allows users to combine all information about a construction object into one system, which connects construction sites and offices with a standardised language for the exchange of information. Through this digitalisation, the supervision workload of managers is thus reduced, and the transparency of the process is enhanced<sup>95</sup>. In addition, the **Latvian Technological Centre (LTC)**<sup>96</sup>, a technological and innovation-oriented structure, acts as support centre to support the growth of knowledge-based SMEs, creating synergies between research and industry. It encourages Latvian SMEs to internationalise and foster transnational cooperation. In particular, the LTC intends to promote the creation and development of high-tech companies and products and create jobs for highly-qualified workers and researchers. At the European level, the Latvian single multi-fund **Operational Programme "Growth and Employment" (OP)**<sup>97</sup>, is also a key element for the development and promotion of innovation. For instance, one of the priorities of the OP is to support R&D SMEs, helping the country to reach its EU 2020 investment target of 1.5% of GDP in R&D and increasing the share of innovative SMEs up to 40%<sup>98</sup>.

Finally, the **Latvian Association of building informal modelling (LatBIM)** aims at promoting BIM development in Latvia and cooperating with state and local authorities, European and global BIM organisations. LatBIM prepares technical documentation work orders and quality requirements for BIM construction designs among others. It also organise events for municipalities, construction boards or trade missions in Georgia, Tbilisi for instance<sup>99</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 May 2017<sup>100</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% by introducing digital solutions;
- achieve a threefold increase in productivity in the sector and therefore rank among the top 10 EU Member States;
- 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 new **Construction Design Documentation** (*Būvniecības ieceres dokumentācijas noformēšana*), specific

guidelines for construction project documentation, electronic design, and implementation of digital construction ideas were established. Similarly, in order to improve productivity, there has been a focus on developing new and more efficient work organisations and technologies. To this effect, the Latvian Ministry of Economics plans to organise workshops in partnership with the sector companies, business executives, construction specialists as well as various building associations<sup>101</sup>.

According to the Latvian Construction Council, the success of the Strategy will depend on the active involvement of the industry in the development and implementation of measures. Indeed, supporting the development of the construction industry beyond 2020 is essential, particularly given the end of EU-funded programmes and projects after the end of the current programming period. This will require the development of new financial instruments to ensure the sustained growth of the industry and the national economy as a whole.

Housing policy in Latvia is under the responsibility of the Ministry of Economics. ALTUM, the state-owned development finance institution, is in charge of 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>102</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.**

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>103</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>104</sup>.

Since its inception and as of February 2019, the scheme has provided 10,608 housing guarantees, for a total value of EUR 75.2 million. . Additionally, a total of 1,000 guarantees have been granted to young professionals at a cost of EUR 7 million. Also, due to the popularity of the program, the government, in February 2019, also approved an additional funding of EUR 2.8 million, for providing support for additional 1,500 families with children<sup>105</sup>. The program has boosted demand for housing in Latvia, while also helping mortgage credit growth turn positive for the first time in 2017. The construction of dwellings, although increased slightly over the short term, has shown little growth in longer term. In stark contrast with the other Baltic countries, the amount of newly constructed dwelling space in Latvia has not increased much since 2010<sup>106</sup>.

In addition, **the Law on Assistance in Solving Apartment Matters** (*Par palīdzību dzīvokļa jautājumā risināšanā*) sets 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>107</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 of current dwelling for a bigger one, providing temporary accommodation, or providing a specialist housing support-service<sup>108</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 parts of the rent, management fees and other fees related to the use of the living space, based on their income<sup>109</sup>. In addition, the municipality partially covers utility costs (e.g. 25% for heating and 50% for water and wastewater) and provides social housing at a rent of EUR 0.06 per m<sup>2</sup>, well below rental market price<sup>110</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>111</sup>.

**Despite these financial measures, national resources invested in the provision of housing support are well below the EU average. Indeed, Latvian government spending on housing benefits is low, accounting for only 0.1% of GDP, compared to 0.6 % in the EU<sup>112</sup>.**

Social housing is scarce and hard to access. As per the 2019 OECD Economic Survey of Latvia, it represents less than 1% of total housing stock, compared to the EU average of 8%. This is far from sufficient to respond to the current demand from around 7,000 people for social housing. Long waiting is forming, especially in Riga. Lower quality of social housing owing to a lack of adequate maintenance add to the problems. Additionally, people can apply for social housing only in the municipality where they already live, making it difficult to move for a job<sup>113</sup>. Housing benefits for low-income households cover in part the rent and utility bills (5 % of population in 2016). However, the coverage is limited and the amounts vary considerably between municipalities<sup>114</sup>.

## Building regulations

**Construction Law** (*Būvniecības likums*), initially introduced in 1995, sets out 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>115</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. The new legislation reduced the number of decisions involved in the construction process. Indeed, after submitting a construction intention and building design, the second step directly entails the issuing of the building permit. Thus, the authorities no longer have to take three decisions (issuing the architecture and planning assignment, accepting the building design, issuing the construction permit), but only one, i.e. issuing the construction permit<sup>116</sup>. Moreover, the time allowed to the building authority to make a decision about issuing the permit is limited at one month. In addition, the revised legislation includes the obligation to inform the public about the planned construction works within 5 days of receiving the permit and regulates in greater detail the qualifications, certifications and responsibilities of the participants in the construction process<sup>117</sup>.

Additional amendments to the Construction Law were enforced in July 2017, aiming to further reduce the administrative burden and increase the efficiency of the construction process. Moreover, the amendments introduce 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>118</sup>.

Sustainability of the Industry and eradication of shadow economy has long been a priority issue on the agenda of both the Government and relevant stakeholders. In 2016, a Memorandum of Cooperation between the Government and the Construction Industry was signed between the Prime Minister, Minister of Finance, Minister of Economics and 12 organisations of construction

industry, aiming to improve the investment environment and reducing shadow economy. Two core measures were identified to eliminate the shadow economy in the construction sector and to stimulate high- quality, safe and sustainable development of the construction industry in Latvia – 1) tracking system of working hours at the construction site and 2) increase of minimum wage. 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 million<sup>119</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 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. 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 shortage by setting the sectoral minimum wage. The latter amounts to 780 euros (819 euros for qualified workers) since November 2019. This is 81% higher than the statutory minimum wage in Latvia (EUR 430) and is positively affecting more than 30,000 employees. Taking into account that the combination of these core measures are fully implemented since late 2019, their positive influence and impacts on the shadow economy are expected to be observed within the following two years.

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*). The law aimed at a complete transition of construction process to an electronic documentation system from January 2019, with municipalities still not ready to implement the system be allowed a transitional period not exceeding 31 December 2019<sup>120</sup>. As of October 2019, within the framework of the European Regional Development Fund (ERDF) project "Development of the Construction Process and Information System (Stage 1)" BIS is being developed as a user-friendly information system. This will enable the entire construction process from design, construction, to operation, to be digitally managed. Additionally, all data related to the building will be concentrated in one place, called the digital shelf of construction documents<sup>121</sup>. Additionally, in November 2019, the second stage of the project has been signed between ERDF, the Bureau of Construction Control (*Būvniecības Valsts Kontroles Birojs – BVKB*) and the Central Finance and Contract Agency (*Centrālo finanšu un līguma aģentūru - CFLA*). The agreement entails at further development of the BIS for effective use of information and communications technology across the construction lifecycle. This will focus on further digital transformation through development of a mobile app, linking the BIM data with that of BIS and enabling functionalities to trace construction waste. The Stage 2 will cost a total of EUR 3.075 million, with around EUR 2.614 million of the cost financed by ERDF<sup>122</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 (*Būvizstrādājumu tirgus uzraudzības kārtība*),

Spatial Development Planning Law (*Teritorijas attīstības plānošanas likums*) and the Regional Development Law (*Reģionālās attīstības likums*), among others<sup>123</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>124</sup>. In case of an annual liability insurance for all construction sites, the limit of the insurance should be at least 10% of the building contractor's annual turnover. Similarly, the limit of the insurance in case of a specific construction should be no less than 10% of the value of the contract<sup>125</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. For instance, the contractor may insure the construction materials used on-site. Rules regarding this particular type of insurance are not mandated by law, and are instead negotiated between the builder and the insurer and detailed in the insurance agreement<sup>126</sup>.

In addition, it is common to take out Contractor All Risk (CAR) insurance for medium and large projects, with the liability limit varying between 5-18% of the contract value, depending on the particular agreement. For large scale projects, 10-15% of the contract value is retained by the client upon completion of the construction works for up to 2 years, in case defects arise. The amount is returned to the contractor if no such issues occur within that timeframe<sup>127</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>128</sup>, has been increasing since 2010 (Figure 10). Namely, investment by the narrow construction sub-sector grew from EUR 88.3 million in 2010 to EUR 137.3 million in 2018 (+55.7%). Investment by the real estate sub-sector increased from EUR 717.9 million in 2010 to EUR 966.5 million in 2018 (+34.6%). In terms of investment in intangible assets, the narrow construction sub-sector invested EUR 2.3 million in intellectual property products in 2018, whereas the real estate sub-sector invested EUR 11.2 million.

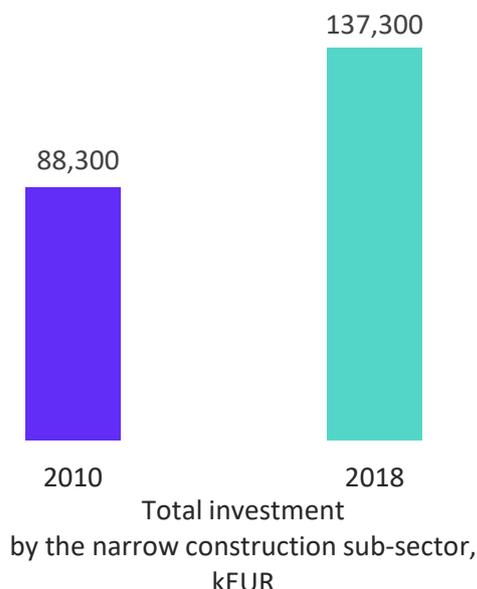


Figure 10: Investment by the Latvian broad construction sector between 2010 and 2018 (EUR m)



Source: Eurostat, 2019.

Despite some fluctuations, total investment in construction<sup>129</sup>, increased by 51.3% between 2010 and 2018 (Figure 11). Investment in non-residential construction and civil engineering, after witnessing a steep decline in 2016, has reported a 58.4% jump in 2018 as compared to 2010. In contrast, owing to consecutive declines in 2016 and 2017, investment in dwellings saw a relatively slower growth of 19.6% between 2010 and 2018.

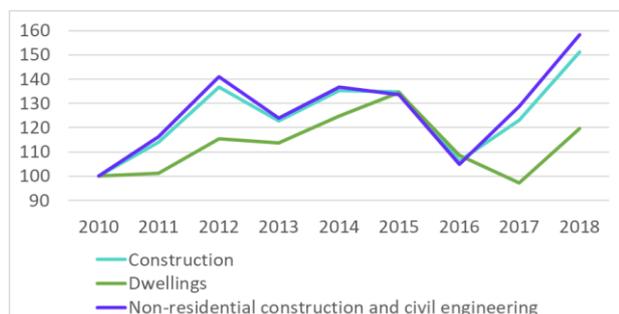
In absolute terms, investment in the construction sector totalled EUR 2.4 billion in 2016<sup>130</sup>, out of which EUR 519.0 million were invested in dwellings and EUR 1.9 billion were devoted to other buildings and structures<sup>131</sup>.

Total investment in the broad construction sector between 2010 and 2018



51.3%

Figure 11: Investment in the Latvian broad construction sector between 2010 and 2018 (2010=100)



Source: AMECO, 2019.

**Total inland infrastructure investment<sup>132</sup> as a share of GDP decreased from 1.1% in 2010 to 0.9% in 2017.**

Investment in road infrastructure in Latvia grew from EUR 131.0 million in 2010 to EUR 226.0 million in 2017 (+72.5%). Conversely, railway infrastructure investment decreased from EUR 73.0 million to EUR 22.0 million over the same period (-69.9%). In parallel, investment in road maintenance went up from EUR 113.0 million to EUR 177.0 million (+56.6%). Similarly, investment in rail maintenance increased from EUR 98.0 million in 2010 to EUR 105.0 million in 2017 (+7.1%).

The transport infrastructure network in Latvia is sufficient to ensure both domestic mobility and international accessibility. That said, measures need to be taken to maintain a sustainable level of quality<sup>133</sup>.

**The quality of transport infrastructure in Latvia, while witnessing improvements in recent years, remains well below the EU-28 average. Latvia is ranked 16 among the EU-28 countries in the 2019 EU Transport Scorecard<sup>134</sup>.**

The quality of Latvian roads is poor, and the country ranks third last Member State in this respect<sup>135</sup>, with approximately 39% of the roads with asphalt surface and 46% of the roads with gravel surface being in a bad or very bad condition<sup>136</sup>. Road planning is carried out in accordance with the **Latvian National Development Plan 2014-2020** (*Latvijas Nacionālais attīstības plans 2014-2020* - NAP). The Plan stresses the importance of the electrification and upgrade of transportation corridors and sets concrete objectives with regards

to the quality of road transport. These include achieving a 100% reduction of the length of major state motor road segments in a poor or very poor condition by 2030 (28% reduction by 2017 and 50% by 2020) and having paved motor roads account for 100% of the total length of regional motor roads (82% by 2020)<sup>137</sup>.

**As part of the 2014-2020 program, a total of EUR 1.3 billion financing from the Cohesion Fund (CF) and European Regional Development Fund (ERDF) is available for the improvement of transport infrastructure<sup>138</sup>.**

There are two key areas of focus. The first relates to sustainable transport system, which includes main motorways, ports and railways, Riga International Airport, and TEN-T infrastructure of Riga. This involves CF co-financing of EUR 924.2 million and ERDF co-financing of EUR 235.4 million. The second focus area concerns the promotion of low carbon emission transport network, electrical chargers for cars, tram infrastructure in Riga, Liepāja and Daugavpils as well as passenger buses. This involves an ERDF co-financing of EUR 7 million and CF co-financing of EUR 108.5 million<sup>139</sup>.

The **Transport Development Guidelines 2014-2020** (*Transporta attīstības pamatnostādnes 2014-2020*) reinforce the NAP and define additional priorities and targets, such as achieving a 20% increase in the length of electrified railways by 2020, ensuring the preservation of national highways and supporting the development of major transport corridor infrastructure<sup>140</sup>.

Based on the documents above, the **National Roads Programme 2014-2020** (*Valsts autoceļu sakārtošanas programma 2014 – 2020*) was introduced in 2013, detailing planned road reconstruction and maintenance projects and required funds. The initial total funding foreseen in the Programme for the 2014-2020 period amounted to LVL 348.7 million (about EUR 528.2 million) for national main roads, LVL 535.8 million (about EUR 816.7 million) for regional main roads, LVL 115.5 million (about EUR 175.1 million) for local roads and LVL 50.2 million (about EUR 76.1 million) for bridge renovation/reconstruction<sup>141</sup>. As of 2018, 273 km of national roads were renovated, and an additional 106 km of regional roads were reconstructed for a total financing of EUR 182.8 million between 2016

and 2018. In 2019, another 66.7 km of regional roads were expected to be completed<sup>142</sup>.

**On November 2018, the Cabinet of Ministers approved the Indicative Railway Infrastructure Development Plan 2018-2022 aiming at providing a competitive rail infrastructure.**

Based on the Indicative Plan, the Ministry of Transport (MT) and the State Joint-Stock Company “*Latvijas dzelzceļš*” (LDz) have concluded a multiannual contract to improve the railway infrastructures. The total network capacity will not be increased. The funds will be invested in maintenance and development projects to boost the efficiency and quality of existing infrastructures. Although the Indicative Plan is not a financial instrument, the plan defined a three-level system model for guaranteeing financial balance: (i) envisaging the involvement of the market participants in the covering of infrastructure costs; (ii) defining that the LDz’s concern provides resources for guaranteeing the financial balance; and (iii) involving funds from the national budget in case of need or in the national economy interests<sup>143</sup>.

The 2018 State Budget amounted to a total of EUR 428.8 million for the transport and communication sectors. Out of this total, EUR 29.6 million are allocated specifically for public local roads and public railway infrastructure. Namely, EUR 25.6 million is dedicated to the improvement of the national main and regional asphalt roads, as well as the upgrade and maintenance of over 300 km of local national gravel roads. By 2020, about 1,000 km of roads will be upgraded. Railway infrastructure will benefit from an investment of EUR 4 million in 2018. Latvia’s 2019 budgetary plan dedicated a total of EUR 236.1 million towards road construction and maintenance.

Notable projects for 2018 include preparing and concluding a contract for the development of the Riga Airport train station and associated infrastructure. Another contract regards the Rail Baltica Riga Railway Bridge and the Riga Central Multimodal Public Transport Interchange Complex<sup>144</sup>. This project is part of the framework of the Rail Baltica project.

Latvia’s **Rail Baltica Project**, aiming to integrate the Baltic States in the European rail network, is expected to miss the initially planned completion

date of 2025. The European Commission, as part of the Connecting Europe Facility (CEF), decided in July 2017 to allocate EUR 110.5 million to the Rail Baltica project. Of the total funding, Latvia will receive EUR 7 million<sup>145,146</sup>. However, the railway electrification project is facing delays and its estimated cost has increased threefold<sup>147</sup>. As of 2019, only 14% of the railway lines are electrified. In terms of completion of the Trans European Transport Network (TEN-T), Latvia has fully completed its TEN-T core road network but has finalised none of the TEN-T conventional rail network (against the EU average of 60%). The missing link of the Rail Baltica project is expected to be completed by 2026 with further investment requirements of an estimated EUR 1.67 billion<sup>148</sup>.

## TO 2 – Skills

**Latvia has implemented several reforms and initiatives to strengthen its vocational education and training (VET) system, including work-based learning and apprenticeships.**

The VET system, which is affected by a poor reputation and little connection to the labour market, is seeing gradual improvements. In 2017, the number of new students entering formal VET programs increased by 13%, as compared to 2016, to around 9,000. The proportion of upper secondary students enrolled in VET was at 38.6% in 2017, below the EU average of 47.8%<sup>149</sup>.

In order to further strengthen the quality of VET system, the Council of the European Union adopted a country specific recommendation under the 2019 European Semester Report for Latvia. The recommendations aim to improve the quality and efficiency of education and training of low-skilled workers and jobseekers, in particular. This will be achieved by strengthening the participation in VET and adult learning programs<sup>150</sup>. Several VET curriculum reforms are therefore being rolled out to promote the competences and skills needed for the labour market in the future and promote work-based learning. It should be fully implemented by 2023. In 2017, the Law on vocational education was amended to provide a legal basis for modular VET programmes<sup>151</sup>.

As part of the current VET system curriculum reform of 2016-2021, 15 sectoral qualification frameworks were officially approved in April 2018. These serve

as guidelines for development and implementation of VET programmes in Latvia. Each framework comprises sector specific occupations, specialisations and levels of qualifications. During 2018, the implementation of work-based learning and apprenticeships was also supported. These include projects such as the cross-border mobility for apprenticeship students, and continuous professional development for VET teachers and in-company trainers. The mandatory training for in-company trainers was also decreased from 72 to 32 hours. Following this, the Employers' Confederation provided training programmes in 2017-2018 enabling 440 trainers to work with apprentices in companies. Altogether, more than 1000 sectoral specialists have attended in-service training to acquire pedagogical minimum to work with apprentices in companies.<sup>152</sup>

To increase the number of students enrolled in work-based learning in companies, a project supported by the European Social Fund (ESF) was launched in 2017, with a total budget of EUR 20.5 million. The project sought to involve 3,150 students in work-based learning and provide an additional 11,025 students with practical training by 2022<sup>153</sup>. Another ESF funded programme for integration of disadvantaged groups was adopted by State Social Integration Agency. The programme aimed at providing tailor-made education and training for people with severe disabilities (the loss of ability to work is in the amount of 60-100%). Five professional training programmes (Clerk, Florist, Horticulturist, Warehouse employee and Carpenter's assistant) and 35 skills training programmes have been developed. The project benefited from a EUR 1.3 million budget, with the ESF contributing EUR 1.1 million<sup>154</sup>.

Moreover, under the project "Increasing the number of modernised vocational education institutions", the government will invest EUR 104.8 million in the modernisation of the infrastructure of 27 VET institutions<sup>155</sup>.

Owing to the reforms, both the enrolments in VET programs and employability of VET graduates is witnessing an increase in Latvia. However, they still remain below the EU-28 average<sup>156</sup>.

In 2018, the employment rates of VET graduates saw a notable increase, reaching 75.8% as

compared to 69.1% in 2017. However, it is still below the EU-28 average of 79.5% in 2018<sup>157</sup>. In 2017-2018, a total of 28,528 students enrolled for VET courses, with a 12% share of adults (aged more than 25 years) enrolling for such courses. The share of adults has doubled since 2011-2012, reflecting the evolution of the labour market and widening offer of education opportunities for people aged 25 and above. In terms of distribution of fields of study, engineering, manufacturing and construction attracted the highest share of enrolments (35%), followed by services (26%), humanities and arts (12%), social sciences, business and law (11%)<sup>158</sup>.

In addition to the broader VET reform, 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 overall goal 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 trainings targeted at the development needs identified in a status quo analysis<sup>159</sup>. A follow-up **BUILD UP Skills Force project (Pillar II)** aimed to identify skills gaps in various construction professions by bringing together education, energy and building industry experts and by establishing an expert group for development of the training programmes. Two continuing education programmes and training materials were elaborated in relation to energy efficient building renovation and nearly zero energy buildings<sup>160</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>161</sup>.

Similarly, the Latvian Association of Civil Engineers offers 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>162</sup>.

The country has seen increased 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>163</sup>.

Finally, 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>164</sup>. To this end, the Ministry introduced **preferential conditions to attract highly qualified specialists from abroad** in the identified professions. Namely, if the employee wants to receive an EU Blue Card, the minimum wage should not be lower than the average gross wage in Latvia. Moreover, foreign workers will be able to fill a vacancy, which has been registered at the State Employment Agency for at least 10 working days (instead of the current requirement of at least a month). The list is also designed to prevent employers from recruiting low-cost labour from third countries. Among the shortage occupations feature construction technicians, civil engineers and sustainable construction engineers<sup>165</sup>.

### TO 3 – Resource efficiency / Sustainable construction

**Household renovation spending** has seen an increasing trend over the years. It amounted to EUR 58.0 million in 2018, 50.3% above the 2010 level of EUR 38.6 million. It accounts for 0.3% of household disposable income, which is at the similar level than that of 2010.

Household renovation spending between 2010 and 2018

↑ 50.3%

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, including the transposition of the EPBD. To implement the requirements of the Directive 2010/31/EC on EPBD, the Latvian government enforced the **Law on The Energy Performance of Buildings** (*Ēku energoefektivitātes likums*) in 2013. It includes provisions related to the energy performance requirements for new and existing buildings, use of high efficiency systems, certification of the energy performance of a building, as well as inspection of heating systems and air conditioning systems, among others<sup>166</sup>.

Energy saving measures and targets are detailed in the **Fourth National Energy Efficiency Action Plan 2017-2020 (NEEAP 4)**, which indicates the improvement of the energy performance of residential, central government and municipal buildings as the main priorities for the 2014-2020 programming period. These will benefit from a planned total amount of EU funds of about EUR 280 million (EUR 150 million, EUR 97.9 million and EUR 31.4 million, respectively). Moreover, measures to increase the energy efficiency and use of renewable energy sources (RES) in the district heating will benefit from EUR 53.2 million in EU funds<sup>167</sup>.

Latvia lags behind in meeting its overall energy saving obligations, especially driven by the residential and transport sectors. This indicates further efforts required to improve overall energy efficiency, driven by reduced energy consumption<sup>168</sup>.

To promote the renovation of multi-apartment buildings, the scheme **Increasing Energy Efficiency in Multi-Apartment Buildings 2014-2020** (*Energoefektivitātes pasākumi dzīvojamās ēkās: 2014-2020*), initially implemented during the 2007-2013 programming period, was extended to the current one. Managed by ALTUM, the scheme offers owners financial aid for energy efficiency improvement measures of their multi-apartment residential buildings<sup>169</sup>. 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>170</sup>. Guarantees can cover up to 80% of a loan taken out

from a financial institution, with the maximum guaranteed amount being set at EUR 3 million<sup>171</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>172</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>173</sup>. The total budget of the programme is EUR 175 million over 2016-2023, of which EUR 150.0 million from the ERDF and EUR 25 million from the state budget. As of March 2019, 457 project applications have been submitted within the support programme. The total ERDF funding requirement for these projects is expected to reach EUR 84.5 million. The implementation of 55 projects is completed, and 78 projects are still under construction to improve energy efficiency of residential buildings<sup>174</sup>.

**The Latvian housing sector is dominated by prefabricated buildings erected between 1941 and 1992. About 95% of these buildings need to be renovated, to help meet the energy efficiency goals of the country<sup>175</sup>.**

The current building stock consists 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**. 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% of these building stocks by 2022, translating to annual avoided emissions of 21 kg CO<sub>2</sub>e per m<sup>2</sup>. LABEEF will support energy service companies (ESCOs) that implement renovation measures in multifamily buildings based on energy performance contracting (EPC). This is an innovative, risk-based financing mechanism in which 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. LABEEF takes loans from European Bank for Reconstruction and Development (EBRD) to forfeit the EPC contracts<sup>176</sup>.

Finally, the **'Let's live warmer' information campaign** (*Informēšanas kampaņa "Dzīvo siltāk"*), which was already introduced during the previous programming period continued. Between 2010 and 2017, 11 cycles of workshops were held throughout Latvia, as well as about 235 information events, including discussions, seminars, conferences and exhibitions<sup>177</sup>.

## TO 4 – Single Market

**Latvia reports a good performance with respect to the metrics of the EU Single Market Scoreboard, particularly in terms of Transposition of Law, Infringements (fifth lowest number of single market-related cases of all Member States) and Internal Market Information System.**

It also shows an above-average level of trade integration in the single market for goods and services<sup>178</sup>. Moreover, its performance in Public Procurement has improved and is now in line with the EU average. However, its score in terms of the single bidder (i.e. the proportion of contracts awarded with only one bidder), no calls for bids (i.e. the proportion of procurement procedures negotiated with a company without a call for tender) and missing calls for bids indicators are still unsatisfactory. Last, the country's score with respect to procedures divided into lots (i.e., the proportion of tenders that have been divided into lots) was average<sup>179</sup>.

Efficiency and transparency in public procurement continues to slowly improve<sup>180</sup>. Indeed, the share of contracts awarded where only one bidder participated in the tender procedure stood at 36% in 2018, compared to the EU average of 24%. Moreover, in 2018, 12% of procedures were negotiated without publishing a contract notice, compared to the EU average of 4%. Moreover, Latvia's procurement procedures are not perceived to be fair, with possible corruptive practices, resulting in limited competition<sup>181</sup>. There are also

concerns with a lack of transparency, especially in low value procurements at the municipality level. The Procurement Supervision Bureau (IUB) carried out 20 investigations on such cases in 2018, as opposed to 45 such cases in 2017. Such cases are further expected to reduce in 2019 with the publication of all procurement-related information on a single website. Focus on leveraging e-procurement is expected to improve transparency and efficiency of procedures<sup>182</sup>.

**Public procurement in Latvia carries a moderately high corruption risk perception, with a perceived lack of fairness and transparency in procurement procedures. Diversion of public funds, favouritism in decision making by government officials, bribery and irregular payments in process of awarding public contracts and licences are other key factors<sup>183</sup>.**

Corruption related issues are even higher in the construction sector and healthcare. Several investigations led by the Corruption Prevention and Combating Bureau (KNAB) were devoted to public procurement, particularly in the construction sector<sup>184</sup>. In one of the most recent cases, the KNAB has raided several major construction companies as part of a 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 to several hundred thousand euros<sup>185</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>186</sup>.

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>187</sup>. Additionally, the **Guidelines on the Essential Requirements to an Internal Control System for Preventing Corruption and the Risk of Conflict of Interest in the Institutions of a Public Person** were approved on 31 January 2018. These guidelines aim to provide recommendations, methodical help and examples for prevention of corruption risks. The drafted document advises on protocols to share the internal anti-corruption control environment, identification, analysis and evaluation of corruption risks and determination of measures for the results of the corruption risks<sup>188</sup>.

**Latvia also reports high levels of shadow/informal economy, with 40% of this phenomenon being ascribable to the construction sector<sup>189</sup>.**

In 2016, the government therefore signed a **memorandum of cooperation** with the construction industry on the reduction of the informal economy in the sector and introduced an action plan for 2016-2018<sup>190</sup>. The introduction of an electronic work record is an instance of the result of increased cooperation between the industry and the public sector, being predicted to promote fairer competition in the construction sector. Additionally, the **Action Plan of the National Authorities in Combating Shadow Economy for 2016– 2020**, aims at reducing its effects in certain key sectors such as construction, transport, security, trade, public catering and accommodation and other services. The focus is on strengthening capacity and information exchange among relevant institutions. This will allow raising timely flags in cases such as suspicious transactions, and registration of new companies. Further it aims to foster fair competition, cash turnover control, mitigation of VAT fraud risks, and prevention of money laundering, among others<sup>191</sup>.

To improve the regulatory and business environment across several areas, including construction and real estate registration, the government implements the annual **Action Plan for Improvement of Business Environment**, within the framework of the National Development Plan 2014-2020<sup>192</sup>. Moreover, the development of **Construction Information System (BIS)** was completed, with a cost of EUR 3.8 million<sup>193</sup>. This is

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>194</sup>.

Latvia regulates the professions of civil engineers. In the case of civil engineers, the activities of engineering research, design, construction works management, construction supervision and construction expert examination are regulated separately, so civil engineers do not have access to all these activities. The existence of this fragmented system creates obstacles to cross-border mobility of civil engineers moving from a country with a unitary system (i.e. where the civil engineer can perform all types of activities) to Latvia<sup>195</sup>.

Finally, with respect to the implementation of Eurocodes, all Parts are published as National Standards and National Annexes are published on all Parts, except for 13 of them. 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. Moreover, there is no particular regulatory framework that enforces their use in public procurement<sup>196</sup>.

## TO 5 – International competitiveness

**Latvia ranks 41<sup>st</sup> out of 141 economies in the 2019-2020 Global Competitiveness Index, behind Estonia (31<sup>st</sup>) and Lithuania (39<sup>th</sup>)<sup>197</sup>.**

Latvia performs in line with the EU average in terms of offering an environment conducive to international trade. The country does particularly well in information availability, advance rulings and formalities – automation. On the other hand, Latvia performs the third last in terms of border agency cooperation. Despite remaining below the EU average, the share of SMEs engaging in extra-EU online exports increased in 2015-2017<sup>198</sup>.

The international expansion of Latvian construction companies is mostly limited to the neighbouring Baltic States (Lithuania and Estonia) and some other countries (Germany and the Netherlands). A large portion of Latvian construction companies are orienting their export activities to the Scandinavian countries – Sweden (52%), Denmark (5%) and

Norway (4%)<sup>199</sup>. The **total export value** of all construction related products witnessed a 140.0% increase, from EUR 591.6 million in 2010 to EUR 1.4 billion in 2018. This reflects the significant increase of activity of Latvian construction companies on foreign markets. The share of foreign orders in the Latvian construction sector has improved from 2.2% in 2010 to 6.8% in 2017, indicative of a good level of internationalisation<sup>200</sup>. This is also indicative of the fact that Latvian construction companies have demonstrated high levels of competitiveness in foreign markets for a variety of trades ranging from general construction to specific installation works. Latvian manufacturers also score well on quality and price competitiveness of their construction materials<sup>201</sup>. Indeed, due to their good quality and competitive prices, Latvian construction products and services are regarded as being very competitive on the Swedish construction market, providing potential opportunities for Latvian companies<sup>202</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>203</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>204</sup>. In 2019, LIAA will support construction companies in trade missions in Germany for instance.

**Latvia ranks 65<sup>th</sup> out of 141 economies in terms of trade openness in the 2019-2020 Global Competitiveness Index, behind Estonia (37<sup>th</sup>), but ahead of Lithuania (70<sup>th</sup>)<sup>205</sup>.**

The country performs specifically well in terms of 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, a lowly, 113<sup>th</sup> in terms of 6 complexity of tariffs<sup>206</sup>. Typical obstacles faced by Latvian construction companies wishing to operate abroad include the insolvency of foreign customers, late or non-payments as well as fluctuations in the economic and political contexts of third countries, which can result in important losses<sup>207</sup>. To this end, ALTUM offers **Export Credit Guarantees** (*Eksporta kredīta garantiju programme*), protecting exporters

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against these commercial and political risks. Namely, the export credit guarantee covers up to 90% of the value of the export transaction in case of commercial risks, and up to 95% for political risks. Moreover, the guarantee covers late payments of

up to 2 years, and its value can amount to up to EUR 2 million<sup>208</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>209</sup>.

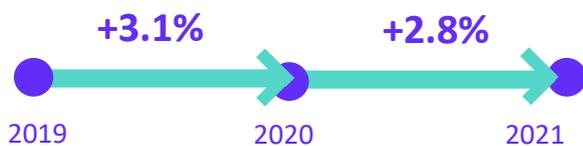
## 8

## Outlook

The Latvian economy has been growing since 2010, with continued strong increase driven by investments and private consumption. The growth is, however, projected to slow down in the coming years.

Economic growth in Latvia has experienced sustained and continuous GDP growth since 2010, even though its GDP is being predicted to slow down to 3.1% and 2.8% in 2019 and 2020, from 4.8% in 2018. The GDP is expected to reach EUR 24.6 billion in 2019, and EUR 25.3 billion in 2020<sup>210</sup>.

Expected GDP growth between 2019-2021

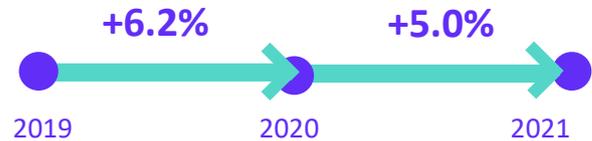


The **production** and consequent turnover in the construction sector are also on the rise after a major decline in 2016. Consequently, the **volume index of production** in the broad construction sector is expected to increase by 25.8% between 2015 and 2020, a 60.0 index point increase from 2010. Total **turnover** of the broad construction sector is expected to reach EUR 10.1 billion in 2020, a 10.9% increase compared to the 2018 levels. In addition, the **value added** of the broad construction sector is expected to grow, with an annual forecasted growth of 6.0% and 4.8% in 2019 and 2020, respectively – reaching EUR 2.9 billion in 2020.

At the same time, the expansion of the broad construction sector is also reflected in the **employment** related trends. The total number of persons employed in the broad construction is expected to increase annually by 6.2% and 5.0% in 2019 and 2020. Put in absolute terms, the broad

construction sector is expected to hire 8,380 workers in 2020 to reach a total of 177,526 workers. This also means that addressing the labour and skills shortage will only become more important in the coming years.

Number of workers employed in the broad construction sector forecast between 2019-2021



The **housing market** and housing price regained its momentum in 2016 due to a solid economic growth, and rising wages and declining mortgage rates supporting the housing demand. However, the housing market is showing signs of cooling off, as the average apartment prices in Riga slightly declined in second quarter of 2019 as compared to a solid growth over the same period in 2018<sup>211</sup>. The number of transactions for new housing projects have been rising at a higher rate than the corresponding supply of new apartments<sup>212</sup>. Nevertheless, demand for housing appears to be predominantly oriented towards existing properties, as shown by the fact that as much as 90% of transactions involve dwellings built during the Soviet period (i.e. before the early 1990s).

The **non-residential construction segment** is projected to experience a positive trend, with a forecasted annual average growth of 5.3% over 2018-2025<sup>213</sup>.

Investments in **non-residential construction** have shown strong performance over the past year. This is driven by high public investments in the logistics infrastructure and office space reflecting the strong performance of the transport and business services sectors<sup>214</sup>. A progressive improvement is also expected in the Latvian retail market, in line

with the recovering economic context. Similarly, the expected increase in the number of foreign tourists will have a positive impact on the hotel market, with the hotel room stock being predicted to increase.

**Civil engineering** is also one of the markets projected to support the expansion of the construction sector. However, the concentration of EU-funded projects in the years 2018-2020 carries risks of a “construction bubble” created by the increased demand for products and services. Thus, construction companies would be competing for skilled workforce, leading to wage growth, thus pushing up the price of services and possibly also

resulting in lower quality (e.g. use of cheaper materials) to try to remain competitive.

**The Latvian construction sector is expected to be propelled by strong building construction activity owing to growing demand for housing, as well as office and industrial space. Outlook for infrastructure investments remains less favourable owing to uncertainties in road construction financing post-2019 as well as impending completion of EU-funded projects. The delays in completion of Rail Baltica project will throw new challenges in terms of additional investment requirements and cost overruns. Additionally, labour market challenges will add to the sector’s complexities.**

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