LATVIA

UNITARY COUNTRY

BASIC SOCIO-ECONOMIC INDICATORS

INCOME GROUP: HIGH INCOME

LOCAL CURRENCY: EURO (EUR)

POPULATION AND GEOGRAPHY

Area: 64 490 km^2
Population: 1.941 million inhabitants (2017), a decrease of 1.2% per year (2010-2015)
Density: 30 inhabitants / km^2
Urban population: 67.3% of national population (2017)
Urban population growth: -1.0% (2017 vs 2016)
Capital city: Riga (32.8% of national population)

ECONOMIC DATA

GDP: 53.6 billion (current PPP international dollars), i.e. 27 592 dollars per inhabitant (2017)
Real GDP growth: 4.5% (2017 vs 2016)
Unemployment rate: 8.7% (2017)
Foreign direct investment, net inflows (FDI): 1 138 (BoP, current USD millions, 2017)
Gross Fixed Capital Formation (GFCF): 19.9% of GDP (2017)
HDI: 0.847 (very high), rank 41 (2017)

MAIN FEATURES OF THE MULTI-LEVEL GOVERNANCE FRAMEWORK

The Republic of Latvia is a parliamentary constitutional republic and “an independent democratic republic”, according to article 1 of the Constitution, which dates back to 1922, with the declaration of Latvia's independence and which was re-ratified in 1993. As a unitary state, it has a President as Head of State and a Prime Minister as Head of Government. The country has a unicameral Parliament (the *Saeima*) composed of 100 representatives elected by direct popular vote for a four-year period. The Parliament elects the President for a period of four years. The Prime Minister is nominated by the President, with the support of a majority in the Parliament. The country has been a member of the European Union since 2004.

The 1992 Constitution does not have any specific provisions giving local self-government a constitutional foundation. However, some articles of the Constitution refer to subnational governments. The Constitutional Court considers that Art.101 on citizen participation in local authority activities is a safeguard for local self-government, and that the highest law on local governance is the European Charter of Local Self Government, ratified by the country in 1996.

The decentralisation process began in 1993 with a series of laws regulating subnational governments. The most important was the 1994 Local Government Act which defines the general framework for SNGs including their organisation, responsibilities and finances. The law provides that “local governments, within the scope of their competence and the law, shall act independently”. It was completed by the 1995 Act on Local Governments Budgets and the 1998 Act on Equalisation of Self-Government Finance (amended in 2015). The same year, the Act on Administrative Territorial Reform was adopted to promote municipal amalgamations. The process has been slow and amendments were adopted to postpone the implementation of the territorial reform until 2009. Finally, the reform was effective on 1 January 2009, following the adoption of The Act on Elections of the Republic city council and municipality council of 2008 and the Act on Administrative Territories and Populated Areas of 2008. It resulted in the abolition of the district level (*rajons*) and in the simplification of the municipal landscape, composed of many small municipalities of different types, which were merged into bigger municipalities.

Between 1998 and 2009, plans had been in the works to replace the 26 abolished districts with self-governing regions (between 5 and 10) that would have had a wider range of responsibility. Finally, regions were not created and regional development responsibility was given to five planning regions, established at supra-municipal level by the State in 2002 through the Act on Regional development of 2002. They are legal entities under public law but are not directly elected. They have indirectly elected regional councils, made up of municipal representatives, acting as “inter-municipal cooperation” bodies created for the purpose of coordinating spatial planning, economic development, public transportation, management of investment programmes (including European Union funds). The regional development council elects the chair and executive director (head of the administration of the planning region). The 2008 Law on Administrative Territories and Populated Areas indicates that the cabinet must propose a new draft law on the full introduction of regional governments but it has not been implemented.

TERRITORIAL ORGANISATION

2018	MUNICIPAL LEVEL	INTERMEDIATE LEVEL	REGIONAL OR STATE LEVEL	TOTAL NUMBER OF SNGS
	110 municipalities *(Novads)* 9 cities *(Republikas Pilseta)*			
	Average municipal size: 16 312 inhabitants			
	119			119

OVERALL DESCRIPTION. Latvia’s territorial organisation is the result of a large territorial reform conducted in 2009 (Law on Administrative Territories and Populated Areas) changing from dual-level municipalities to single-level municipalities: 524 local authorities (municipalities, rural territories, district towns, “republican cities”) were merged in one single tier of government, comprising 110 municipalities (*Novads*) and 9 “republican cities” (*Republikas Pilseta*) under state jurisdiction.

Republican cities are urban administrative territories, with well-developed commercial activities, transport and community jurisdiction facilities, social and cultural infrastructure, as well as a minimum population threshold of 25 000 inhabitants. Other municipalities are the result of the merger of several rural administrative territories, or of a former urban town and the surrounding rural administrative territories. Five municipalities have several towns in their territory. Despite this distinction between republican cities and municipalities, their competences and sources of revenue are the same.

Each local government has a local council (*dome*) as a legislative body. Its members and councillors are elected by direct universal suffrage for four-year mandates. Members of the local council then elect the chairperson (*priekšsēdētājs*) of the council for a four-year term.

Municipalities are quite large on average, amounting to around 16 300 inhabitants (median size 6 600 inhabitants) but there are large disparities in terms of demographic size: municipalities range from 1 060 inhabitants for the smallest to 639 000 inhabitants in Riga, the capital city. Around 35% of municipalities have fewer than 5 000 inhabitants and 5% less than 2 000.

Riga is the largest city in the Baltic States. The Metropolitan area of Riga (Riga Planning Region) is home to more than half of the Latvian population and contributes to about 69% of national GDP. While the benefits of coordination across local governments within the metropolitan area of Riga are receiving increasing attention by Latvian municipalities, no formal governance arrangements covering the entire metropolitan area are yet in place. Riga is one of the republican cities but does not have a specific legal status as capital city.

Municipalities are divided into sub-municipal divisions, including 76 towns and 497 civil parishes under county jurisdiction.
Besides planning regions which can be considered as forms of inter-municipal cooperation, cooperation between municipalities, which is authorised by the Local Government Act, is well developed in areas such as cultural and sporting activities, education and transport services.

SUBNATIONAL GOVERNMENT RESPONSIBILITIES

The Local Government Act enacted in 1994 and amended several times since then, regulates the organisation of local authorities and their competences. Local governments have three types of competences: mandatory autonomous functions set out by law, autonomous functions performed as voluntary initiatives, and delegated functions on behalf of the State. Each type of task has to match its own funding source. In compliance with the law, the government, when it delegates tasks to municipalities must ensure that those municipalities have the resources necessary for the performance of such tasks. The Latvian system also includes a general residual clause of competence. Local government competences cover the provision of basic services, housing, local planning and community amenities, environment, education and social assistance and social services. Municipalities also rely on local public companies to provide local public services. There were 78 "capital companies" in 2016 which mainly operate in the areas of water supply and sanitation and waste management.

MAIN RESPONSIBILITY SECTORS AND SUB-SECTORS

	MUNICIPAL LEVEL
1. General public services	Registration services (birth, land registry, etc.); Collecting statistical information
2. Public order and safety	Municipal police; Public order and civil protection
3. Economic affairs/transports	Economic development (facilitating economic activity); Licencing for commercial activities; Public transport; Local roads; Public infrastructure
4. Environmental protection	Public management of forests and water
5. Housing and community amenities	Local planning; Social housing; Public space; Water and heating supply; Waste management
6. Health	Hospital maintenance; Health care
7. Recreation, culture & religion	Sports; libraries; Local museums; Culture
8. Education	Pre-school; Primary and Secondary education; Organisation of continuing education for teaching staff
9. Social protection	Personal social services; Child protection; Elderly; Disabled.

SUBNATIONAL GOVERNMENT FINANCE

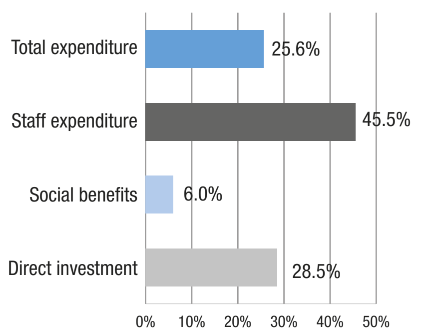
Scope of fiscal data: municipalities, counties and local government organisations, as well as capital companies controlled and financed by local governments.	SNA 2008	Availability of fiscal data: **High**	Quality/reliability of fiscal data : **High**

GENERAL INTRODUCTION. Revenue and expenditure assignments to local authorities are specified under the 1994 Local Government Act. Other key pieces of legislation relating to fiscal matters and fiscal relationships between national and local governments are the Act on the Budgets and Financial Management of 1994, the Act on Local Governments Budgets of 1995, as amended, the 1998 Act on Local Government Finance Equalisation, amended in 2015, and the Act on Taxes and fees of 1995, as amended. According to art. 96 of the Law on Local Governments, municipalities are regularly consulted by the central government through the Latvian Association of Local and Regional authorities and participate in the decision-making process, in particular concerning fiscal issues.

SUBNATIONAL GOVERNMENT EXPENDITURE BY ECONOMIC CLASSIFICATION

2016	DOLLARS PPP / INH.	% GDP	% SNG EXPENDITURE
Total expenditure	**2 429**	**9.5%**	**100%**
Inc. current expenditure	2 139	8.4%	88.1%
Staff expenditure	1 190	4.6%	49.0%
Intermediate consumption	617	2.4%	25.4%
Social expenditure	185	0.7%	7.6%
Subsidies and current transfers	124	0.5%	5.1%
Financial charges	22	0.1%	0.9%
Others	1	0.0%	0.0%
Incl. capital expenditure	290	1.1%	11.9%
Capital transfers	17	0.1%	0.7%
Direct investment (or GFCF)	273	1.1%	11.2%

% GENERAL GOVERNMENT EXPENDITURE (SAME EXPENDITURE CATEGORY)



EUROPE

LATVIA

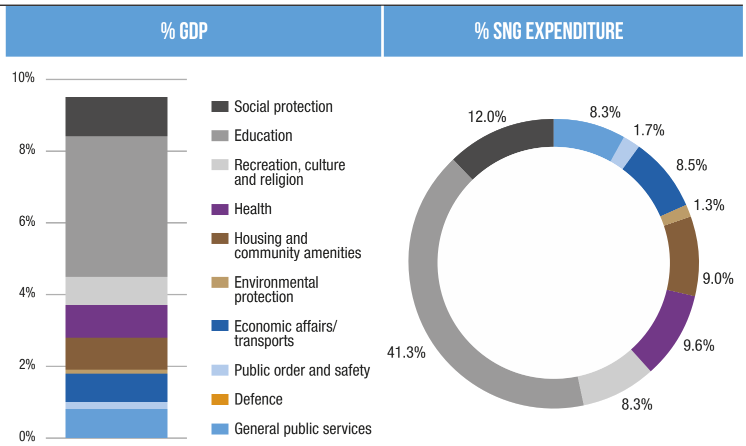
UNITARY COUNTRY

EXPENDITURE. The share of SNG expenditure in GDP and total public expenditure is in line with the OECD average for unitary countries (respectively 9.2% of GDP and 28.7% of public expenditure in 2016) but below the EU28 average (15.3% of PDG and 33.5% of public expenditure). The share of staff expenditure in SNG expenditure is particularly high (49.0% vs 31.3% on average in the unitary countries of the OECD and 32.9% in the EU28. The share of SNG in public staff spending is also high, in line with international standards (on average 43.0% in OECD unitary countries and 50.9% in the EU28). These high ratios correspond for the large part to teacher wages. In fact, Latvian public employment as a share of the active working population is the highest among EU countries, and local authorities account for 60% of public sector employees.

DIRECT INVESTMENT. SNG investment amounted to a small share of GDP and public investment in 2016, compared to international standards: respectively 1.7% of GDP and 50.7% of public investment in OECD unitary countries and 1.4% of GDP and 51.6% of public investment in the EU28. Latvian SNG investment has been severely affected by the crisis and fiscal consolidation measures, decreasing by 4.3% per year in real terms between 2007 and 2017. In addition, Latvia is heavily dependent on EU Structural and Investment Funds (ESIF). Latvia will receive up to EUR 5.6 billion until 2020 i.e. around 3% of GDP annually over the period 2014-2018 and 65% of public investment. In 2016, Latvia, like other EU countries benefiting the most from cohesion funds, has suffered from a "cliff effect" - suddenly turning negative after the 2015 deadline for payments under the last EU programming period. In 2017, SNG investment seems to have rebounded, amounting to 1.7% of GDP and 42.1% of public investment.

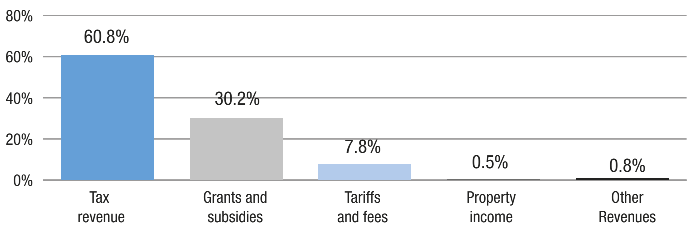
SUBNATIONAL GOVERNMENT EXPENDITURE BY FUNCTIONAL CLASSIFICATION – COFOG

A significant share of SNG expenditure is allocated to education, in particular for the payment of teachers' salaries, and the financing of the maintenance and operating costs of educational facilities. Education accounts for almost half of SNG expenditure, a much larger percentage than the OECD and EU averages (respectively 24.8% and 19.6%) as well as 3.9% of GDP, in line with the OECD average (4.0%) and above the EU28 average (3.1% of GDP). Far behind, social protection is the second most important area of SNG spending, followed by health spending. SNGs in Latvia are also responsible for the majority of public spending in housing and community amenities, and to a lesser extent in recreation, culture and religion.



SUBNATIONAL GOVERNMENT REVENUE BY CATEGORY

2016	DOLLARS PPP / INH.	% GDP	% GENERAL GOVERMENT REVENUE (SAME REVENUE CATEGORY)
Total revenue	**2 487**	**9.7%**	**26.1%**
Tax revenue	1 513	5.9%	26.0%
Grants and subsidies	750	2.9%	
Tariffs and fees	193	0.8%	
Property income	12	0.0%	
Other revenues	19	0.1%	



OVERALL DESCRIPTION. The level of SNG revenue in GDP and public revenue is below the EU28 average (respectively 15.3% of GDP and 33.5% of public revenue). The main source of SNG revenue is taxes, which are mainly shared. Tax revenue accounted for almost 61% of SNG revenue, a level well above the OECD average for unitary countries (38.7%) and the EU28 average (44.6%). By contrast, the share of grants and subsidies is lower than the averages for the OECD unitary countries and EU28 (respectively 48.8% and 44.1%) while revenues coming from local public services (tariffs and fees) and property income account for a small share of SNG revenue, below OECD and EU28 averages.

TAX REVENUE. As a share of GDP and as a percentage of public tax revenue, SNG tax revenues are slightly above the OECD average for unitary countries (4.7% and 19.8% respectively).

According to the 1994 Act on Taxes and fees, all taxes are "state taxes". As a result, there is not own-source taxes in Latvia in a technical sense. All taxes benefiting SNGs are apportionments in the collection of some State taxes i.e. shared taxes.

The most significant shared tax is the personal income tax (PIT): its receipts represented 84% of SNG tax revenues in 2016, 51.1% of SNG revenue and 5.0% of GDP. The PIT is regulated and collected by the State Revenue Service. It is partially redistributed to municipalities according to residence criteria, i.e. the number of inhabitants. In 2017, each local authority received 80% of the tax collected in its territory. Municipalities with wealthy residents receive more money than a similar authority with the same number of inhabitants but having less economic capacity.

Another important shared tax is the property tax levied on all land and buildings, either used for commercial or housing purposes (since 2010). 100% of receipts are redistributed to municipalities. In 2016, it accounted for 15% of local tax revenue, 9% of local revenue and 0.9% of GDP, below the OECD average (1.1% of GDP in 2016). It is a fully local voluntary tax, yet local governments can modify the tax rate since 2013 within limits set by the State. Besides, the uniform application of the property tax is distorted by local practices. Some local authorities provide property tax rebates which are more than compensated for by income tax revenue, leading to tax competition between local governments.

Moreover, local governments also receive 25% of the tax on lotteries and gambling and a share of the natural resource tax (which must be used for environmental protection purposes only). The natural resource tax is split into sub-taxes (tax on pollution, on radioactive waste, incineration of dangerous waste). The public tax system is being overhauled by a reform adopted in the summer of 2017. The key measures focus on the reduction of personal and corporate income taxes at the general government level.

GRANTS AND SUBSIDIES. Nearly all grants from the central government are earmarked and in 2016, 96% of them were current grants, against 4% of capital grants. Transfers include, in particular, grants for the remuneration of teachers, road maintenance and construction, investment projects or financing of EU projects.

The main non-earmarked grant is the Local Government Finance Equalisation Fund (LGFEF). The local government financial equalisation system was created in 1995 to compensate for the significant differences in the financial capacity among local governments in Latvia and regulated in 1998 through the Law on Local Government Finance Equalisation. The LGFEF aims at balancing the different tax capacities (measured by revenues from PIT and property tax) and an estimation of the "financial needs" related to the municipalities' responsibilities, which is itself calculated using several demographic criteria. The share of the LGFEF is significant for some municipalities. In 2013, the fund was fed by five republican cities and 13 municipalities from the Riga region, while it benefitted 92 local government units. 10 local governments did neither receive or finance the fund. Again in 2013, 77% of the LGEF was funded by contributions from republican cities, 11% from municipalities and 12% from the state budget grant.

The equalisation law was amended in 2015 and a new system introduced in 2016. It contains revised principles for the evaluation of demographic and income criteria, and takes into account the property tax, in order to bring the incomes of the less wealthy local governments closer to those of wealthier municipalities.

OTHER REVENUES. Other revenues come from user charges and fees for administrative services, issuance of official documents and certificates, ownerships of animals, advertisement, delivery of construction permits and other administrative offences. In 2016, tariffs and fees accounted for 0.8% of GDP in 2016 and almost 8% of SNG revenue. Revenues generated by asset sales and rentals, as well as generated by local public companies represented 0.5% of the SNG revenue in 2016.

SUBNATIONAL GOVERNMENT FISCAL RULES AND DEBT

2016	DOLLARS PPP/INH.	% GDP	% GENERAL GOVERNMENT DEBT	% SNG DEBT
Total outstanding debt	**991**	**7.4%**	**15.2%**	**100%**
Financial debt*	807	6.0%	13.5%	81.5%

* Currency and deposits, loans and bonds

FISCAL RULES. The budget process is governed by the Law on Budget and Financial Management both for central and local government, including a budget balance rule for municipalities.

DEBT. SNGs can only borrow long term to finance investment projects (golden rule). However, they do not have free access to the banking system or the capital market, as loans must be contracted with the State Treasury or within specific funding programmes. Borrowing from another institution must be justified and authorised by the Ministry of Finance.
SNG borrowing in a given year cannot exceed 20% of current revenues (excluding earmarked grants and contributions to the Equalisation Fund). In case of non-compliance, the National Treasury can apply sanctions, and SNGs may be placed under supervision. Total local borrowing is overseen by an interministerial Council for Loans and Guarantees.

In 2016, SNG debt amounted to 7.4% of GDP, a level which is below the OECD average for unitary countries (14.5% of GDP) and the EU28 average (14.3% of GDP). As a share of public debt, Latvian local debt is slightly above the OECD average for unitary countries (11.8% of public debt) and the EU28 average (14.4%). Financial debt ("Maastricht debt") makes up the bulk of total outstanding debt (81.5%), the remaining part being composed of insurance pensions. Financial debt is composed exclusively of loans as local governments cannot issue debt securities.

SNGWOFI
World Observatory on Subnational Government Finance and Investment

Lead responsible: OECD
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Socio-economic indicators: OECD // Eurostat // World Bank // UNDP // UN Desa // ILO // Latvia Central Statistical Bureau
Fiscal data: OECD National Accounts Statistics // OECD Revenue Statistics // OECD (2018) Subnational Government in OECD countries: key data (brochure and database) // Eurostat
Other sources of information: Congress of Local and Regional Authorities (2018), Local and Regional Democracy in Latvia, Monitoring Committee // European Commission (2018), Country Report Latvia 2018 // Garcia K., Jewell A., Tudyka A., (2018), Republic of Latvia, Selected issues, IMF // OECD (2017), "Latvia", in National Urban Policy in OECD Countries // European Committee of Regions (2016) Division of Powers // Vilka, I. (2015), The role of local government finance equalisation on rural development in Latvia, University of Latvia, Riga.