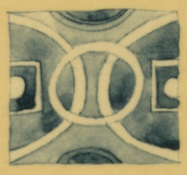

Valdis Avotiņš, Jānis Birzulis, Edvards Kušners

Development of Small and Medium Businesses in Latvia

A Research Paper on the Influence of Changes in Legislation on Business

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To the Reader:

The contribution of small and medium business to various sectors of the national economy and their share of the GDP exceeds 50% in some countries. As a rule, small and medium business is characterized by a faster rate of growth. They are more flexible in adjusting to market changes, are relatively more cost efficient and have a higher operating efficiency. By carrying out supply contracts for large companies, picking up vacant market space and being a significant source of employment, small and medium businesses are often authors of new initiatives and make inroads into specific market sectors in which large corporations have no interest. The middle class, which increases as a result of business development, has an important role to play in ensuring democracy and social stability and development of fair competition and private entrepreneurship.

However, in the Eastern and Central European countries in transition, the small and medium business sector is still in its an embryonic state. As a rule, any business development begins in the capital and then gradually spills over to other towns and cities, while in the rest of the country, particularly rural areas, business develops slowly. Such development can only be described as weak because it usually involves only one or two sectors.

Even though in the process of their development small and medium businesses have been able to absorb a significant number of jobs left vacant during the privatization process or the following restructuring of the large enterprises and agricultural enterprises, it is only during the last two years that any serious attention has been given to promoting business development in Latvia. To date no analytical study of the growth of small and medium business and its role in the national economy has been done in Latvia. Similarly, understanding of the importance of the private sector in the development of a balanced and sustainable national economy is forming very gradually.

This study is the first attempt to study more extensively how the business environment affects the development of small and medium business in Latvia, and prepare recommendations for the promotion of business. The study was carried out with the support and assistance of the Soros Foundation in Latvia and covers the period from the renewal of independence to January 1, 1999. Similar studies have been carried out in Hungary in 1996 and 1997, where they caused considerable public repercussions.

The study is made up of three parts. Part 1 provides a review of the growth and development trends of small and medium business and the role of the government in regulating it. Part 2 looks at the effect of development of and changes in legislation on business environment and gives a comparative assessment of what positive or negatives consequences changes in the law have wrought on the growth and operations of companies. Part 3 summarizes the main conclusions and recommendations to improve the situation. Some of the recommendations have already been implemented by implementing the government approved plan of action to reduce administrative obstacles and harmonizing the legislation with EU normative acts.

While working on the study, the authors have made use of the reports, studies and other material of an analytical nature of many local and international organizations. Of the better known sources we need to acknowledge the NAIS data base, the regular ME Reports on Development of the National Economy, OECD, UNDP, EU Phare, FIAS & WB and IFC reports, the Hungarian study Small and Medium-sized Enterprises in Hungary in International Perspective, EU Phare, May 1998, CSP newsletters, reports and publications as well as the study carried out by T. Tisenkopfs and others, *How the Small Businessman Feels*. A Report to the Latvian government, published in Rīga by the FSI of the University of Latvia, September 1998, and others.

We hope that this study will benefit economists, lawyers, businessmen, representatives of various interest groups and NGOs, everyone linked to business operations and development of normative acts regulating same, and will promote an exchange of views.

We would like to thank A. Augstkalna, B. Gulbe, D. Azanda, O. Baranovs, A. Strupišs and M. Mellēns who have contributed much to this study at different stages and have encouraged the authors to apply a more precise standard to their conclusions and better analyze their compiled material.

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Acronyms and Abbreviations used in the Study

BL	Bank of Latvia
CIS	Commonwealth of Independent States
CM	Cabinet of Ministers (Republic of Latvia) or Council of Ministers (in former LSSR)
CR	Company Register
CSB	Central Statistical Bureau
EICC	European Information Corresponding Centre
EPC	Environmental Protection Committee
EU	European Union
FIAS	Foreign Investment Advisory Service of the WB
GDP	Gross Domestic Product
IB	Individual Business
IPS	Institute of Philosophy and Sociology
LC	Labour Code
LC LSSR	Labour Code of the Latvian Soviet Socialist Republic
LGA	Latvian Guarantee Agency
LTC	Latvian Technology Centre
LDA	Latvian Development Agency
LEC	Latvian Export Credit
LEMAP	Export Marketing Cost Sharing Grant Scheme
LMLB	Latvian Mortgage and Land Bank
LSSR	Former Latvian Socialist Soviet Republic
ME	Ministry of Economy
MEPRD	Ministry of Environmental Protection and Regional Development
MES	Ministry of Education and Science
MF	Ministry of Finance
NAIS	Normative Acts Information System
NLDF	Norwegian–Latvian Development Fund
NRS	National Revenue Service
Phare	EU Programme for Assistance to Central and Eastern European Countries
RF	Regional Fund
RL	Republic of Latvia
RTU	Rīga Technical University
R & D	Research & Development
SCR	Supreme Council of the Republic of Latvia
SDR	Special Drawing Rights
SEZ	Special Economic Zone
SHC	Shareholding Company
SIA	Limited Liability Company
SME	Small and Medium-sized Enterprise
UL	University of Latvia
VAT	Value Added Tax

The Economic Development of Latvia

Latvia renewed her national independence in 1991, after the collapse of the USSR. Under the Soviet system of planned economy Latvia stood out among the Republics in industrial development, whose gigantic enterprises supplied the demands of the Soviet market and carried out orders of the military. The percentage of exports exceeded 65%, of which 95% went to other regions, and the percentage of industry in the GDP exceeded 50%. The industry employed about a third of all those employed. After the renewal of independence, when free market reforms were started and thus sales were reduced, the demand for production manufactured by the large enterprises decreased rapidly. GDP fell by more than 50%. The downturn also affected the subsidized agricultural sector, established on the basis of collective management, as well as food processing. The percentage of the service sector grew, determined by the development of the transport and communications sectors. Unique to Latvia is the large concentration of the population in Rīga and its surrounding area, differences between urban and rural areas showing a tendency to increase, as well as the fact that the population is decreasing as a result of the low birth rate and external migration.[1]

The first positive success gained as a result of reforms was checked by the bank crisis in 1994, which considerably weakened public trust in the financial system. However, thanks to the stable lat and the rigid fiscal policy, inflation continued to drop falling from 950% in 1993, when prices rapidly adjusted to levels of world prices, to 2.8% in 1998, one of the lowest in Eastern Europe.

As a result of the consistent government reform policy, the successful and rapid privatization process, the business friendly legislative environment, harmonized in many areas with normative acts of the EU, a stable GDP growth rate can be observed during recent years: 3.3% in 1996, 8.6% in 1997, and 3.6% in 1998; the increase in 1999 is evaluated at 0.5%. Not withstanding that the comparatively rapid trend of positive development was affected at the beginning of 1998 by the financial crisis in Russia and some companies whose main market was linked to the CIS countries had to reduce their production, all in all a small rate of growth was evident in GDP in 1999.

The macro-economic stability may also be endangered by the trade deficit with its related current account deficit, which reached 10% in 1998. Until

Table 1 Latvia: Basic Indicators of Economic Development*

	1995	1996	1997	1998	1999e	2000f
	(growth compared to previous year, in percentages)					
GDP (in comparable prices)	–0.8	3.3	8.6	3.6	0.5	4.0
Private consumption	0.6e	10.3	5.0	5.8	1.0	3.0
State consumption	7.7e	1.8	0.3	5.3	1.5	0.9
Forming a joint basic capital	8.7e	22.3	20.7	11.1	5.0	6.0
Consumer prices	25.0	17.6	8.4	4.7	2.4	3.0
	(In percentages of GDP unless indicated differently)					
Fiscal assets of the total balance	–3.1	–1.4	1.2	0.1	–4.0	–2.0
External debt	9.2	8.0	6.7	6.1	9.3	10.1
National foreign and domestic debt	16.0	14.4	12.0	9.9	12.9	14.0
Balance of foreign trade	–13.0	–15.6	–15.1	–17.6	–14.5	–14.4
Current account of expenditures balance	–0.4	–5.5	–6.1	–11.1	–10.3	–9.2
Rate of registered unemployment (% at the end of the period)	6.6	7.2	7.0	9.2	9.1	8.0
Exchange rate of Lats compared to SDR (at the end of the period)	0.7997	0.7997	0.7997	0.7997	0.7997	0.7997

* Source: Central Statistical Bureau, Evaluation and Forecast Ministry of Economy.[2]
e – Evaluation; f – Forecast

1 See also R. Zīle et al, Latvia on the Threshold of the 21st Century: economy, finances, integration. Rīga, UNDP 1999, PP. 152, and Latvia. The Transition to a Market Economy. The World Bank country study. Washington D. C.

2 Report on the Development of the Latvian National Economy. RLME, December 1999.

Table 2 The Latvian Gross Domestic Product by Sector*

	1995		1996		1997		1998	
	Rate of growth %	Structure %	Rate of growth %	Structure %	Rate of growth %	Structure %	Rate of growth %	Structure %
Total value of GNP in base prices	–0.8	100.0	3.3	100.0	8.6	100.0	3.6	100.0
Among those:								
Agriculture	3.1	10.4	–5.3	8.7	4.9	5.6	–4.8	4.5
Processing industry	–0.5	22.4	4.1	20.9	17.1	22.2	3.4	20.2
Electricity, gas and water supply	9.9	5.5	–1.9	5.3	–0.7	5.0	1.1	3.9
Construction	–9.5	5.1	5.3	4.7	8.2	4.8	11.1	5.2
Services	–2.1	56.0	5.0	59.9	7.5	62.0	4.7	65.8

* Source: Ministry of economy.[3]

now the current account deficit was covered by the significant flow of direct foreign investment and export of services, especially in the transit sector. This is increased by the macroeconomic stability, development of infrastructure, improvement of business environment, a cost competitive labour force, the favourable geographic location, joining the WTO and invitation of Latvia to start negotiations to join the EU. The dynamics of the main macroeconomic indicators are shown in Table 1.

In order to achieve a stable, balanced and sustainable economic growth that would ensure increased prosperity and security for the population and development of democracy, a government regulation is needed alongside trade mechanisms. The approach to the Latvian economic system (model) is provided in documents of short and long term economic policies, and priority tasks are listed in 13 national programmes, which are medium or long term target programmes. In order to reach these targets, the period before the year 2003 must achieve an annual increase in the GDP by 5 to 6%, reduce inflation to 4% per year and reduce registered unemployment to 5 to 6%. This determined that in 1999 government support increased as appeared in a number of projects targeted to promoting growth of SMEs.

During the last three years the service sector, especially transport and communications services, trade, use of real property, leasing and commercial operations, information technologies developed more rapidly. Any increase is mainly evident in sectors using domestic resources and low quality labour. Steady growth can be seen in sectors of the processing industry, such as food, pulp and paper, wood processing, textiles and manufacture of building materials.

The competitiveness of Latvian companies can be described by increased exports and innovative capacity. Compared to other Eastern European countries, the Latvian rate of export is low both in terms of total volume and by the proportion of export in GDP. The slow rate of increase in exports at the beginning of the reforms can be explained by the undeveloped foreign trade system and lack of quality standards required by Western countries. In 1998 export of goods increased by 10%, but import – by 19%. As a result of the Russian crisis, the percentage of goods going to CIS countries in the total trade volume decreased from 30% in 1997 to 19% in 1998, but the percentage to EU increased from 49% to 57%. However, the percentage of production manufactured using modern technologies does not exceed 5% of total exports.[4]

The self-regulating liberal market of the market economy is able to promote SME development only up to a certain level, especially in the case of international competitiveness, regional development, creating new jobs in new sectors, and availability of capital resources.[5] It is especially important for Latvia to activate the growth of SMEs, involving same in the economic circulation, increasing competitiveness of SMEs, use of domestic resources and achieving increased employment. Even though on September 9, 1997 the government conceptually adopted the Latvian national programme of SME development, its effective implementation is threatened in the year 2000, too, because the funds necessary to implement the planned projects have not been provided in the national budget.

3 Report on the Development of the Latvian National Economy. RLME, December 1999.
4 High-tech or high VAT products as understood by EU or OECD definitions.
5 OECD, Baltic Forum for Entrepreneurship and Enterprise Development. Policy Guidelines, Riga, September 1999.

Development of SME

Definition of Small and Medium Business

Table 3 Criteria Guiding the EU in Defining SME[6]

	EU up to 1996			EU since 1996		
	Micro	Small	Medium	Micro	Small	Medium
Number of employees Sub-categories	1–9	10–99	100–499 100–249 250–499	1–9	10–49	50–249
Maximum annual turnover, MEUR	–	5	20	–	7	40
Maximum balance value, MEUR	–	7	10	–	5	27

In many countries SME is one of the most important elements of economic policy; however, there is no single common definition of SME. Since 1998 EU member countries consider any business or company a SME if it complies with certain criteria, set out in Table 3, and is not engaged in agriculture, hunting, forestry or fishing. Of all EU companies, 99.9% are SMEs.

In order for an EU company to be considered SME or a micro-business, it must comply at least by the number of employees and one of the financial categories. Furthermore, the company must be independent, i.e. another company or group of companies may not hold more than 25% of the company's shares. The usual period for review of criteria and approval is four years, and the purpose of such a procedure is a more flexible adjustment to changes in the economic situation.

Latvia, as opposed to many EU and Eastern European countries, has no specific law to define SME

Information about the Role of SME in Developed Countries

In developed countries, SMEs form the backbone of the market economy. They provide 75%–90% of all new jobs. Furthermore, it is the micro-businesses (up to 10 employees) which employ 75%–85% of all those employed in the country. SMEs have an even greater importance in employing the rural population, and diversification of business and development of new types of business is an important factor of regional development. SMEs contribute up to 90% of new production, compared to the large companies. In SMEs, a more rapid innovating process is ensured by a more flexible motivation, relatively lower operating costs, end result targeted approach, thus achieving a higher operating efficiency, and the ability to take higher risks and adjust more readily to the demands of a dynamic market.

Large companies are effective in sectors which (1) require a concentration of large capital investments to develop, (2) have an extended manufacturing cycle and, (3) where manufacturing requires large capacity equipment or in which global competition stimulates a concentration and merging of resources.

No less importantly, SMEs promote growth of the middle class which in turn stabilizes society; SMEs free large companies from performing uncharacteristic functions and cause a reduction of the grey economy and black market. In a poor country, democracy is warped and most of the population is poor. Thus during the period of transition to market economy a well targeted establishment of private business in Latvia must be considered one of the most important priorities.

SMEs are successful where:

- a large variety of goods and services is required, continuous introduction of the new, the personal taste and initiative of the staff is important;
- it is necessary to reduce unemployment and promote competition;
- the consumption factor is important, namely to provide the population with consumer goods;
- is necessary to free the large companies from uncharacteristic functions, thus promoting specializing and co-operation, sub-contracts; many SMEs operate under contract with large companies, supply raw materials, and sell finished production;
- it is necessary to establish a wide strata of business people and owners.

[6] DG Enterprise. EC Recommendation of April 3, 1996 concerning the definition of SMEs, OJL 107 of 30.4.1996, P. 43.

status. The Central Statistical Bureau uses the EU SME criteria, namely, a micro-business has up to ten, and a medium business up to two hundred fifty employees. Regarding fiscal relief, several laws mention small business in one or another regard. For example, the law "On Corporate Income Tax" provides the following maximum levels for small business criteria: value of basic assets – Ls 70,000; net turnover – Ls 200,000; and average number of employees – 25. In turn, the law "On Control of Government and Municipal Support Provided to Business" defines SMEs as companies employing not more than 250 persons and, similarly to EU, which have complied with one of the financial criteria – annual turnover is less than two million Lats or maximum balance value does not exceed Ls 1 million. It must be noted that the national programme for development of SME does not define precisely what is SME, but merely lists the aforesaid cases. Such inconsistency makes it difficult to prepare and implement a government policy to support SME.

In this study, according to EU practice and definition, which can be observed in most of the Eastern European countries, we shall consider a microbusiness to be a business employing not more than 9 persons, and a small business one which employs not more than 49 persons, and a medium business, one which employs not more than 249 persons.

SME Support Policy

National Programme for Development of SMEs

The purpose of the Programme is to promote development of stable and competitive SMEs and create a favourable business environment.

The Programme set the following medium term goals for the period up to the year 2000:

- a hundred SMEs per thousand residents (at present the number is less than 10);
- endeavour to have a hundred to a hundred and fifty new businesses established annually.

For the first year the following achievable short term goals were set:

- endeavour to have twenty five active SMEs per thousand residents;
- endeavour to have the number of SMEs in industry increase by 25%;
- endeavour to have production of SMEs increase by 25%;
- increase the number of new jobs in small companies by 20%, in medium companies by 10%;
- endeavour to increase the SME contribution to the GDP by 2%.

Important sub-programmes:

1. create a business environment promoting SME operations;
2. endeavour to ensure access to capital for long term, relatively small and risky or innovative projects on terms that would stimulate SME development;
3. increase the competitiveness of existing SMEs by promoting transfer of technologies, export and international co-operation;
4. establish a business-supported, targeted, qualitative infrastructure that would be able to ensure demand by providing an appropriate system of professional education, consultative services and training.

In order to implement the Programme, the CM formed a Co-ordinating Council, under which subcommittees for improving legislation, regional development and financial matters started to operate, and the ME established a department of SME development policy. In order to begin implementing the Programme, it was envisaged to carry out a number of important steps: establish a favourable legal environment and reduce administrative obstacles, develop organizations to support small companies, projects to promote development of technology, implement a training programme, and provide assistance in preparing business plans, as well as strengthen existing financial support instruments and draft new ones.

In order to begin active implementation of the National Programme for SME Development, about Ls 3 million were required from the national budget for the first eighteen months, gradually increasing this funding over subsequent years. Government funding could attract donor assistance and co-financing from international organizations at least in equal amounts. The National Programme would include trade businesses and self-employed tradesmen (not more than 5 employees). However, in 1998, instead of the requested Ls 2.25 million, the national budget allocated only Ls 0.075 million. Until 1999 the main support for SMEs came from the EU Phare Programme.

What has been achieved over the two years? The Latvian Guarantee Agency and the Regional Development Fund were established, the Innovation Concept was drafted, a partially subsidized consultative and training programme was implemented, a support scheme of direct subsidies and "soft credits" was established for new and micro-businesses, four new Business Support Centres and four new Innovative Centres were established and their staffs trained, and business people are provided with targeted business information services. Rural business is co-ordinated by the Latvian Mortgage and Land Bank, extending credit to areas which as a rule are not served by commercial banks. A system was drawn up and implemented for government support for business, and at the end of 1999 the CM approved, in principle, a credit/loan concept to promote SME development.

At first only indirectly linked to this Programme, the study, prepared by the World Bank Foreign Investment Advisory Service (FIAS) and the LDA, "Latvia. Administrative Barriers to Investment", created a basis for a plan of projects containing 60 various tasks, which was approved by the CM in May 1999. As a result of a consistent and transparent implementation of legal acts, not only were customs procedures and tax administration simplified, but also the process for obtaining building permits, company registration and operations of several inspectorates affecting business were streamlined.

However, the main discrepancy of projects intended for SME development is their isolation and lack of uniformity, co-ordination and financing, as evidenced by the problems or even liquidation of some of the Business Support Centres established as far back as 1993. Also, the Programme is barely linked to municipal business and employment promotion programmes.

Without the support of local authorities it will be practically impossible to achieve the goals set by the Programme. Municipal contribution is small, dictated by their limited resources and a lack of long-term interest. In an average municipal budget up to 50–70% of the total revenues are made up of transfers from the municipal equalization fund and various target subsidies from the national budget. Because the tax collection system is centralized and has changed several times over the years, municipal budgets are not stable and are difficult to predict. As income increases, there are no guarantees that it will stay at the same level for the next year; if so, transfers from the equalization fund or target subsidies from the national budget may be cut. Business support instruments available to municipalities are very limited. Only about 25–50% of revenues are obtained within the municipal territory itself in the form of tax and lease payments.

Altogether, the government fails to give sufficient attention to promoting SME export ability and innovative development. The plan of action approved in September 1997 to implement the National Programme for SME Development is in many areas merely a written recommendation which has not been implemented. However, it is possible that, with Latvian consistently moving towards the EU and beginning to implement the National Development Plan, financing for the National Programme for SME Development could increase considerably.

Government Support

Governmental Support System

Small businesses often have difficulty finding their way under the changing market conditions. Therefore active support of government policy is needed to assist these companies in their operations and increased competitiveness by creating conditions precedent for business growth and to increase opportunities for their owners and staff in the future, thus ensuring economic stability and development.

On February 26, 1998 the Saeima passed the law "On Monitoring Government and Municipal Support Provided to Business". This law applies to both producing and processing sectors, as well as the service industry. This law does not apply to support provided to companies whose basic operations relate to education or health care, organization of sports events, social care, preservation of cultural/historic heritage and environmental protection if the aforesaid operations receive government support. The general requirements of monitoring government support do not apply to assistance to agriculture and fisheries.

The law provides that government support (funding) may be provided:

- in the export areas (for company participation at international shows and fairs and one time foreign market research, and this support may not exceed 45% of the total costs);
- for regional development (regulated by specific normative acts);
- for studies, obtaining patents or introduction of new technology (to 100%);
- for the introduction of environmentally-friendly technology (to 45%);

- for saving energy and producing energy by renewable energy resources;
- in the area of increasing employment and improving working conditions;
- to companies in crisis situations;
- for services of consultants and training (only for SMEs, up to 75% in territories needing special support, up to 50% elsewhere);
- for the introduction of quality control (consultations and preparation of appropriate documentation);
- for investment in basic assets (in individual cases up to 50%);

The amount of government support for SMEs may be increased by 10–15% if needed.

Although legislative acts provide procedures for obtaining government support, they do not include a sufficiently considered and laid down mechanism for stimulating increased competitiveness of companies within the limits permitted by law. Since the government does not provide sufficient financing for the development of SMEs, regional development and export promotion, reality lags considerably behind need.

The present support system fails to regulate the proportion of SME in the market of public procurement, which at present is relatively small. The largest customers of SMEs are municipalities, however, municipal budgets restrict the size of their orders. Under these circumstances, in the case of larger public procurement it would be advisable to determine a more precise status for sub-contractors which SMEs could realistically claim, or even special SME quotas.

The total size of government support for SME in Latvia, compared to other Eastern European countries, is much smaller. During the period 1992–1998 the EU Phare Programme contributed about 5.7 million ECU or Ls 3.81 million to SME development, while the government co-financing represented only Ls 0.85 million.

Tax Relief Available to SME

In order to promote growth of SME, legislative norms include certain tax relief.

The Law "On Corporate Income Tax" provides that a tax discount to small businesses is 20% of the total corporate income tax calculated if at least two of the following conditions have not been exceeded during the pre-taxation year:

- value of basic assets – Ls 70,000
- net turnover – Ls 200,000
- average number of employees – 25 people.

According to the Law "On Value Added Tax", a business may register as a taxpayer regardless of the

Table 4 Comparison of Instruments of Government Support Available to SBMs, in the EU, Hungary and Latvia[7]

Support instrument	EU	Hungary	Latvia	Remarks
General tax stimulus	X	X	X	Contradictory and changing
Support for technologies and R&D	X		(X)	Within the EU programmes – a limited available science fund; partially Latvian Environmental Investment Fund, Energy Efficiency Fund
Regional development	X	X	(X)	Opportunity to subsidize loan interest within 15% of the territory of the RL
Support for sub-contracts	X	X		
Export	X		X	LDA provides LEMAP and export training programmes, support for participation at shows. In view of termination of Phare programme, continued availability of this support is threatened
Employment	X	X		LR – only for training of the unemployed
New Business	X	X		Phare supported until 1996
Information and consultations	X	X	X	LAA EICC services
Available funding	X	X	X	Several funds
Education and training	X	X		On commercial terms
Co–operation	X			

[7] Regarding EU and Hungary: Small and Medium-sized Enterprises in Hungary in International Perspective. EU Phare, May, 1998. Regarding Latvia: authors' note.

scope of its transactions, which means that small businesses are entitled to tax free amounts. VAT is not levied on capital goods imported by a person subject to VAT to ensure the technological process of manufacturing in Latvia, provided the same technology is not manufactured in Latvia and it is not imported by the official distributors of these goods.

The Law "On Annual Reports of Companies" provides a simplified reporting system for companies complying with the small business requirements. This Law does not apply to farms and fisheries and individual businesses whose annual income from their operations does not exceed Ls 45,000 at the start of the report year and who file with the National Revenue Service only those reports related to tax payment.

If a business is registered and operates in accordance with the Law "On Regions in Need of Special Support" within a certain region in need of special support,[8] and a decision has been adopted as provided by CM concerning the compliance of the development project to the development programme of the region in question, basic assets which the business has acquired while the region in question has the status of a region in need of special support and which it uses in its business operations within this region, the purchase value prior to calculation of total amortization prior to the taxation period of the relevant category of basic assets is increased by multiplying by the following coefficients:

- basic assets of category 1 (buildings, construction) – 1.5;
- basic assets of category 2 (energy equipment, facilities and others) – 1.3;
- basic assists of category 3 (accounting equipment, information systems) – 1.8;
- categories of basic assets (all other basic assets) – 2.

Government support is also provided in special laws and CM Regulations for operations within the Free Zones and special Economic Zones. At present there are four Free Zones established in Latvia: The Rīga Commercial Free Port, Ventspils Free Port, Liepāja and Rēzekne SEZ. Within these zones income tax is reduced by 80% of the tax amount calculated on income obtained within the territory of the SEZ. Import of goods to the territory of the Free Zone from other countries and export to other countries is exempt from VAT, while other fiscal stimulation is also available.

For companies and farms which are engaged in agricultural operations, not subject to exemption from corporate income tax as provided for small businesses, regardless of other types of operations, relief from corporate income tax is determined at Ls 10 per hectare of arable land. Farms which are not VAT payers receive VAT compensation for their farm production produced and supplied to processing plants. Farms are reimbursed for excise tax paid on diesel fuel for use on their farms. Resident income tax is not levied on income gained from agricultural production provided it does not exceed Ls 3,000 annually.

According to Article 40 of the Law on Energy, SMEs engaged in producing electricity in small hydro electric stations, or individual co-generating facilities, may sell their surplus electric power for eight years at double the average tariff for electric power to licensed distributing companies. In turn, companies using energy regenerating facilities whose capacity does not exceed 7 MW (using the following sources: geothermal energy, bio-fuel except wood and peat, wood shavings, household waste or their processing waste, biogas) may sell their surplus electric power for time and a-half of the average sales tariff to licensed distributors for eight years.

Instruments of Government Financial Support

Experience in supporting SME gained by economically developed countries confirms the following opportunities for making use of mechanisms and funds: insurance, establishing security and guarantee funds, tax exemption in areas of innovations, a flexible system of loan interest rates depending on the importance and priority of the project; developed mutual credit systems; mortgages; participation of small businesses in supplying public procurement; establishing joint government leasing services and authorized commercial representation systems; establishing guarantee funds for foreign investment in the area of small business; and risk capital as an important part of innovation mechanisms.[9]

Several government support structures have been established in Latvia with the participation of the

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[8] This status has been granted to sixty four municipalities, including five Latgale regions (except the Daugavpils region; The Rēzekne region is included without the territories of Griškāni and Vērēni parishes), six towns and fifty five parishes (*pagasts*) and towns within the territory of Latvia.

[9] G. Oļevskis, I. Kuzmina. Small Business in Latvia and the Need for Government Support to its Development, Rīga, 1998.

government and foreign donors, where private companies may obtain financial assistance, mainly by way of loan guarantees and investment in basic capital. These are:

- the Latvian Guarantee Fund
- the Norway–Latvia Business Development Fund (LDA holds all shares in the Fund);
- the Regional Fund;
- A/S: Latvian Export Credit which provides export and import guarantees;
- the Rural Development fund;
- the Energy Efficiency Fund;
- the Environment Investment Fund.

In addition, there is the Export Marketing Financial Support Scheme and Support Fund for Exhibitions and Fairs, provided by the LDA.

Government support for SMEs is also provided in the form of subsidized consultations and training programmes. With the financial assistance of the EU Phare Programme, a network of business support and innovation centres has been operating in Latvia for five years, providing consultations, training and assistance in writing proposals to small business.

The total capacity of all the aforesaid institutions is relatively small, they lack uniformity and often overlap in their activities. In 1998 funding of about Ls 8 million was paid out directly to businesses through various support funds, but Ls 1.2 million or 15% of the amount was spent to administer the funding.[10] It is therefore not surprising that only a small number of businesses had approached these organizations and had received support. Businesses lack information on support programmes; more than half of all business people had no knowledge of any of the support projects. This shows a lack of information exchange among the government, support organizations and the private sector. Only a few companies have asked for and received support. This situation shows both the insufficient level of information, the lack of trust on the part of business people in government support projects, and their real opportunities to receive assistance, or the insufficiently stimulating nature of the desired assistance. In order to concentrate the available resources and make maximum use of them, a concept on "Co-ordination of Operations of Government Business Development Funds" was prepared and submitted to the government at the end of 1999, which provided for the establishment of a Fund Co-ordinating Council and simplification of administration of the Funds, possibly merging some of them.

However, all in all government support projects have failed to affect a large part of business and a large number of businesses have no information regarding these or do not know that these projects are in fact implemented in order to support SMEs. Western, Central and Eastern European countries make extensive use of various financial instruments, several of which are not available to Latvian SMEs. Table 5 shows instruments of government support available in Latvia.

The government has approved government guarantees of Ls 10 million in 2000 for a SME loan project. In the year 2000, the LMLB will extend granting of government-guaranteed loans. The first step in this direction is the agreement signed with *Kreditanstalt für Wiederaufbau* (KfW), which will permit the LMLB to grant long term loans to SMEs for up to ten years at an average interest rate of 9%. This programme will be implemented for at least two years, providing loans for a total of up to € 300,000 to manufacturing, tourism and service companies.

Government Support for Development of Technology

The small amount of government funding (in 1998 – 0.23% of GDP and 0.54% of the total national budget) and the small number of researchers employed by private business represent a considerable obstacle to development of technology potential.[11] Government financing in Latvia represents about 70% of the total funding for business research, although in developed countries the government portion seldom exceeds 30%, because most funds for research come from the private sector. This funding structure shows a slow restructuring of the research system and shows that the percentage of industry of modern technology within the Latvian industry is small.

In 1997, the government determined the following to be research priorities:[12] 1) organic synthesis, bio-medicine and pharmacy; 2) raw material sciences; 3) information technology; 4) forest and wood

[10] Without participation of the LMLB. Concept of a Project coordinating operations of government business development funds, RLME.

[11] *B. Berg-Andersson, Comparative Evaluation of Science & Technology Policies in Lithuania, Latvia and Estonia, Helsinki, ETLA, Discussion Paper, 1997.*

[12] Report on the Development of the Latvian National Economy, RLME, No. 6562k; Protocol No. 6, 28.01.1997.

Table 5 A Summary of Instruments of Financial Support Available to SMEs in Latvia

Financial Instrument	Latvia	Description
Direct grants or subsidy projects	None	This group partially includes grants allocated by MES to applicants for business research, among which are companies or groups of researchers.
Micro credits	None	This type of credit project is targeted to micro, small and newly established companies. Loan interest is lower than that in the present market, and such loans are small. Another aim of the project is to provide companies with a credit rating and encourage the lending bank to continue to work with these borrowers. For example, in Hungary, twenty thousand such loans were granted in one year under this project.
Small loans	Phare	1. The credit line established in 1993 (1 million ECU) has turned out to be a negative "experiment". Of the 3 banks involved, "Banka Olimpija" went bankrupt, "Parex" returned the funds not spent and withdrew from the project, as a result of which in 1999 DM 840,000 were not put to use at all, but ECU 419,500 repaid on the loans extended, were frozen in the Bank of Latvia. The only bank that stayed with the project, the Latvian Credit Bank, continues to grant loans. 2. The $ 25 million of the World Bank have been successfully paid out to companies operating in the areas of agriculture, forestry and food processing. The last two of these do not exceed 10% of the credit granted by the WB. In all projects funded by the WB the borrower must secure the loan by the appropriate guarantees, thus the bank's (LMLB) risk was small and bad loans amount to only 0.01%. 3. On September 8, 1998 the LMLB signed an agreement with the WB for a credit line of $ 25 million for the development of rural business. Some of these loans are earmarked for a target loan group (loans not more than Ls 2,000) intended for rural businesses taking out a loan for the first time whose security does not exceed the amount of the loan, have a permanent place of residence and are starting a viable business. The borrower must invest at least 10% of the total estimated cost of the project, either in cash or in kind. The borrower may also apply for Government co-financing of 30% of the amount of the loan to be used for purchase of new goods.
Guarantee projects	LEC	1. The Latvian Export Credit (LEC) offers the following guarantees (for projects of Ls 3,300): ■ Export insurance: export payment guarantees, guarantees for financing, guarantees for purchaser's credit, letter of credit guarantee; this permits the exporter to obtain cheaper loans. ■ Import guarantees: guarantees of payments and financing; ■ Export financing (new, small businesses, small loans); ■ However, the main problem is the relatively small funds available to LEC, thus it can only finance no-risk projects. In 1998 LEC supported 52 projects in a total amount of Ls 3.7 million. Although the registered basic capital of LEC is Ls 5 million, to be reached by January 2000, at present it amounts to only Ls 708,000 or 14% of the intended amount. Thus the amount of transactions covered by LEC is small. For example, in 1997 it was only 0.55% of total exports, while at least 5.7% or Ls 36–40 million are needed, which is the same as in Slovenia.
	Phare	2 On January 21, 1998 the Latvian Guarantee Agency was established (with a capacity ECU 700,000 and Ls 500,000). It provides medium and long term loan guarantees to SMEs for up to 70% of the amount of the loan, thus reducing the risk of banks and other financial institutions in lending to SMEs and providing loans to SMEs at lower interest rates. The LGA has signed an agreement with the Bank of Latvia concerning the status and use of guarantees provided by the LGA to banks granting loans to SMEs. In 1998 one project was supported in an amount of Ls 10,000. The maximum guarantee for a loan is Ls 100,000.
	RDF	3. Rural Development Fund. With a capacity of Ls 5 million, it guarantees up to 30% of investment in agriculture, granted to rural producers. The maximum amount is Ls 35,000. Guarantees are without surcharge.
Financial support programme for export marketing	LEMSP/ Phare	Intends to support export marketing activities of fifty to sixty companies by subsidizing up to 30% of the company's expenditures related to introducing products to a new target market. Support is given for printing of advertising material, participation in shows including travel expenses, certification of production in other countries, staff training. Subsidies may not exceed Ls 10,000. The budget of the

Financial Instrument	Latvia	Description
		programme is Ls 580,000 and € 380,000. By the end of 1999 seventy one applications were received, 38 projects from 31 companies were approved for a total of Ls 200,362.
Investment in basic assets of companies	NLDF	1. The Norwegian–Latvian Development Fund, established in 1994, invests in the development of SMEs up to 45% of the basic assets of the company seeking support, between $ 10,000 to $ 400,000 US. The SME is changed to a shareholding company. The investment is temporary, between three to five years. No investment is made in trade and commerce.
	RF	2. Regional Fund (at present this area is of secondary priority. In 1999 it was 1.6% of the total). In 1998 it invested in a/s "Balvu Maiznieks" (Balvi Bakery).
Payment of loan interest	RF	In April 1998 a state enterprise SIA Reģionu attīstiba (Regional Development) was established. The task of this Fund is to promote business activities in areas needing special support by supporting projects showing a reasoned business plan and action programme and, if the relevant municipality is interested, in its implementation. The Regional Fund may invest in a company's basic assets, it has made one time payments, such as creating new jobs or economic educational projects, investment rebates, i.e. partial compensation of capital investment. The Fund may also pay interest (partial) on medium and long term loans, in specific cases providing loan guarantees. Support of the Fund is available in territories needing special support only, namely 15% of the territory of Latvia. In 1998, 77 support agreements were signed (in total 171 projects were supported), using Ls 250,000 to implement them. Altogether, by using Ls 777,000 (Ls 3.417 million) 463 (2,600) new jobs will be created. In 1999, 386 projects were supported, using up to a Ls 1.5 million to support business activities.
Innovations and risk investment	MES	1. Business research fund. Funds technology centres and parks, and subsidizes and lends to research SMEs. It permits many SME tenants of technology centres to receive less expensive services and reduce rent (39 companies, employing 280 people) and technology parks (28 companies, two hundred employees). Total amount available for support for physical infrastructure of innovations is about Ls 100,000 annually.
		2. The ME is currently working on a concept of an Innovation Fund and SME Development Fund. The SME Development Fund would grant micro loans and risk loans to manufacturing SMEs, subsidize loan interest, make investment in basic assets and development of infrastructure of companies.
Sector programmes	Phare	1. The energy efficiency fund (€ 3.6 million) and funds of the LMLB not less than 20% of Phare funds, at present € 1 million is already available, will provide technical assistance and grant loans. Total funds amount to € 30,000–400,000; the borrower must invest his own funds, at least 30% of the total loan, and loan interest may not exceed 12%. The fund begin to lend in 1999.
	LEIF/ Phare	2. Environmental investment fund (€ 2 million) grants loans for environmental projects related to water supply and reduction of contamination. In 1998, 13 loans had been granted for a total of Ls 1.2 million, 38 more projects were reviewed for a total of Ls 10 million. Criteria are important improvement of the environment as a result of the project, a term of up to 10 years, a viable project, 8% interest rate per annum, and repayment may be postponed for up to 12 months. Fund participation in project may be up to 80% of the cost of the project; however, the average is 40%. An advance of 1% of the amount of the loan is required. This is a Fund for the support for introduction of environment friendly technology.
Employment	NONE	Individual Funds in Eastern European countries are planned to support involvement of social risk groups – young people, the disabled and women – in business. The Residential Housing Construction Fund should also be mentioned here to support businesses in this sector and link them to certain areas. Latvia may receive grants for training registered unemployed.
Consultations	SC/Phare	A SME training and consultation programme, partially subsidized by EU Phare programme, implemented by BSC, innovation centres. Such a centre has also been established as part of the Technology Centre. However, because of termination of the Phare programme and availability of pre-joining EU funds, a business restructuring programme has been started, providing assistance to about ten medium businesses to introduce innovative methods. Emphasis is transferred from increased competitiveness to development of innovative technology.

technologies; 5) Latvian (national) studies. Projects promoting innovative activities in Latvia were partially started as early as 1991, when a system of funding was established to carry out research and studies demanded by the market, and basic principles for the development of technology (innovation) centres were prepared. The first of these was the Latvian Technology Centre (LTC) established in 1993, the Latvian Technology Park (LTP) established in 1996 and was based on the infrastructure of the Rīga Technical University (RTU).

The work thus started should be concluded with a document duly considered and approved by the government concerning industrial policy would be one of the main tasks of which to promote development of new technology, cooperation between universities and business, the transfer of technology, and growth of innovative SMEs. In the development of technology centres and industrial parks, initiative in developing infrastructure is important and should be appropriately reflected in respective national development programmes.

Information about Latvian Technology Centre

The LTC occupies 2,200 m^2 and operates as an innovative incubator, providing a wide variety of assistance to technically oriented companies. During the past six years the Centre has grown considerably and at present involves 39 companies employing 28 scientists holding. The total annual net turnover of these companies in 1998 reached Ls 1.6 million, paid in excess of Ls 160,000 in taxes, and created 285 new jobs. The total number of new products created was in excess of 500. Of the companies in the Centre, 30% export an average of 20–60% of their production to Western countries. Until 1995, 90% of the total costs of the LTC were paid from the national budget. In 1998, this figure was only 65%. The funding which companies received from the business research programme in 1998 was repaid to the Government five times over. Because of lack of risk-loans, the LTC company "SALVE" terminated operations in Latvia and established itself in Spain, with an annual turnover of $ 10 million.

A General Description of SME

Business development in Latvia was strongly affected by the economic reform process and development of a legislative basis. The comparatively simple conditions of establishing a business society, lack of capital and weak competitiveness during the first years of independence caused the emergence of many weak and small businesses which often did not look at long term operations to start with. Therefore, their chances of survival and development under conditions of a changing market were limited. The SME sector in Latvia is gradually increasing and becoming involved in the general economy, thus increasing the use of domestic resources and promoting the growth of the national economy. SMEs account for 99% of the total number of companies, employing about 60% of the working population. According to the ME, they produce up to 50% of GDP and their taxes contribute significantly to the national budget and solution of the unemployment problem. During the period 1991–1999 SMEs created more than 300,000 new jobs.

Number of Companies

Company registration was started in Latvia in 1991 and in March 2000 the number of companies in the Company Register reached 147,000, approximately 50 companies per thousand residents. During the past two or three years an average of approximately 6,000 to 8,000 companies were registered annually. However, of all the legally registered companies only some have begun operations. According to the Central Statistical Bureau, on February 1, 1999 less than 40% of registered companies were active. Since data of the Company Register show mainly filing of documents and only a year later the active companies file their annual reports, for the purposes of this study we shall make use of data provided by the CSB, based on regular statistical reports, which show the business situation considerably more correctly. Among the companies registered with the Company Register, approximately 430 garage and gardening co-operatives and public organizations, which do not perform actual business operations, are not monitored. Table 6 shows that about 60% of all companies registered with the CSB, not including farm holdings, can be considered inactive, but according to an analysis performed by the CSB, at the end of February 2000, 5,140 companies cannot be found. This explains the difference in numbers in the reports of the CR and the CSB.

Table 6 Number of Inactive SMEs by Year of Registration (not including farm holdings)

Companies	1991	1992	1993	1994	1995	1996	1997	1998	1999	Total
Total	10,853	13,714	12,148	12,296	4,741	3,234	2,520	2,341	914	62,761
Struck from CR	5,648	7,862	7,020	6,315	722	315	130	58	4	28,074
Bankrupt or considered insolvent	283	267	200	74	93	61	29	12	1	1,120
Terminated operations but not struck from CR	1,693	1,999	1,904	1,775	1,161	777	431	223	33	9,996
Have not started operations or have ceased operations	1,247	1,683	1,716	2,321	1,515	1,386	1,417	1,734	717	13,736
Whereabouts unknown	589	538	463	476	461	318	337	183	43	3,408
Considered inactive for other reasons	1,393	1,365	845	1,235	789	377	176	131	116	6,427

Source: CSB; as at end of February 2000; * companies registered by 01.08.1999.

Table 7 Number of Active SMEs by Year of Registration

Number of employees	1991	1992	1993	1994	1995	1996	1997	1998	1999	Total
0–9	1,887	2,674	3,191	4,298	3,281	3,611	4,065	4,469	1,998	29,474
10–49	852	1,195	1,154	1,041	658	668	534	372	184	6,658
50–249	317	309	271	246	137	107	91	60	36	1,574
>250	65	56	38	47	21	15	19	11	8	280
Total	3,121	4,234	4,654	5,632	4,097	4,401	4,709	4,912	2,226	37,986

Source: CSB; as at end of February 2000.

Note: Table 7 permits only approximate assessment of total of active companies in each year because during the report period a company could suspend or restrict operations several times.

The most active period for establishing companies was 1992–1995, when about 75% of all companies registered with the CSB up to the beginning of 2000 and which show signs of activity. Since 1996 a slowing down of the rate of establishing of new companies can be observed. However, at present the number of actively operating companies is much smaller, because during the past two years many companies which had terminated their operations some time ago, had not even started or failed to comply with the requirement to increase their basic assets to Ls 2,000 were struck from the registers (CR, CSB, taxpayers register). Thus, the percentage of companies established in 1991–1995 is only 57% at present.

The dynamics of companies registered with the CSB business register confirms a gradual increase in business activities and establishment of new, far more stable, companies. However, the involvement and viability of new companies in the Latvian market cannot be considered especially active. The number of companies terminating or temporarily suspending their operations increased about as rapidly. At the end of 1999, compared to the same time period in 1996, the number of active companies has decreased by 12.4%.[13] This trend shows a more orderly business environment and that various subjective and objective factors have gained a higher significance, permitting the establishment and start of operations of only those companies which have defined their niche of operations, which are able to find sufficient starting capital, and which provide good initial business and management organization. The growing competition has considerably reduced the frequency of establishing new companies. However, it is a concern that during the first 7 months of 1999, 30% of companies registered with the CSB could be considered inactive.

From a standpoint of length of survival, 1995 was critical. As a result of the banking crisis, a large number of companies established during previous years terminated their operations (50.2% of all companies registered in 1991). Furthermore, 27% of companies registered in 1994 did not start operations at all.[14] The trend of registering new companies and then sus-

[13] Latvia. Human Development Report. UNDP, Rīga, 1998.
[14] CSB files.

Table 8 Number of Active Companies by Size

Corporate form	1–9	10–49	50–249	>250	Total
State enterprises	21	52	56	8	137
Municipal enterprises	217	212	151	41	621
SIA (Limited liability)	18,848	5,401	1,005	93	25,347
A/S (Shareholding)	221	266	262	128	877
Individual business	9,266	439	15	0	9,720
Share companies	111	53	40	1	205
Other forms	790	235	45	9	1079
Total	29,474	6,658	1,574	280	37,986
Proportion, %	77.6	17.5	4.1	0.7	100.0

Source: CSB as at end of February, 2000, not including garage and garden co-operatives.

Table 9 Employment Figures by Size of Company

Sector	Indicator	Total	0–19	20–49	50–99	100–249	250–499	500–999	>1000
Total	No. of employees	595,990	166,867	78,640	71,028	92,469	61,361	44,967	80,658
	Proportion %	100	28.0	13.2	11.9	15.5	10.3	7.5	13.5
Public	No. of employees	139,115	5,151	9,294	15,580	19,831	20,766	17,060	51,433
	Proportion %	23.3	0.9	1.6	2.6	3.3	3.5	2.9	8.6
Private	No. of employees	456,875	161,716	679,346	55,448	72,638	40,595	27,907	29,225
	Proportion %	76.7	27.1	11.6	9.3	12.2	6.8	4.7	4.9

Source: CSB as at January 1, 1999.

Note: Number of employees according to salary tax books, annual cards and self-employed. Does not include women on child care leave. The public sector figures include state and mixed ownership with state capital shares as well as municipal ownership companies.

pending operations does not depend on the corporate form of the company.

Only about 30% could have been operating for longer than five years. Among the more active SMEs, dominant are mostly micro businesses established in recent years (Limited Liability Companies and Individual Businesses), and more than 80% of those were established without a previous basis and outside the privatization process. The percentage of these companies in the general economy is small. ME analysis shows that the total percentage of the private sector in the national economy is determined mainly by the values created by privatized state enterprises.[15]

Employment

The SME FSI analysis for 1998, too, showed that the average number of employees in companies had increased in 1998. According to this analysis, employment had increased comparatively more rapidly in medium-sized companies, which can be explained by the completion of the privatization process and a more rapid growth of companies with state capital shares. In most companies (63%) all employees work full time, and in 32% of companies, employees work full time as well as part time, and in only 5% of all companies did employees work part time only or were contract workers.

Description of Active Companies

A division of SMEs by size and sector has stabilized over the past two to three years and does not differ much from indicators in other Eastern European countries. The service sector dominates, especially trade, but in manufacturing, the intensive sectors and sectors using domestic resources, which means small limited liability companies and family businesses. Such companies, although there are exceptions, have limited opportunity for rapid development and become involved in international business, demonstrating high competitiveness. It must be said that in most cases and especially outside Rīga and other large cities, SMEs are usually oriented to providing a

[15] Report on the Development of the Latvian National Economy. RL EM, 1998 and 1999 publishing.

Descriptions of Active Companies

Most active companies at the end of February 2000 were micro and small businesses,[16] employing not more than 10 people. Thus, micro businesses (not more than 9 paid employees) made up 77.6% of the total active companies, small (10–49) and medium (50–249) – 17.5% and 4.1% respectively. The number of large companies is less than 0.7% of the total number of companies, although their contribution to GDP is significant.

The largest proportion of micro businesses is among individual businesses (95% of their total), among SIA, 74%, but division of shareholding companies according to number of employees, is even: 22% of these are micro businesses, 31% small and 30% medium businesses.

About 48% of active SMEs of the total number of companies are engaged in retail trade, 13% in manufacture, 6% in construction, 6% in the transport sector, 4% in the hospitality industry, 21% provide other services. This structure of sectors of main operations has remained practically unchanged over the past two to three years.

Looking at the division of companies by corporate form (Table 10), we see that the proportion of micro (possibly family) businesses, is larger in the trade sector (85%), but in other sectors, according to the UNDP report[17], limited liability companies dominate, except in the financial sector. The proportion of small and medium business among active companies in manufacture and construction sectors is larger in company categories employing between 11 and 49 and fifty to 99 employees respectively. Companies employing more than fifty people are mostly concentrated in the manufacturing sector (32% of all medium and large companies).

Table 10 Classification of Active Companies by Size and Corporate Form

Sector	Up to 9	10–49	50–249	>250	Total	Proportion, %
Agriculture	590	284	96	9	979	2.5
Fishing	109	46	2	1	158	0.4
Industry	2,764	1,439	482	109	4,794	12.6
Construction	1,261	577	181	14	2,033	5.6
Trade	15,801	2,310	263	27	18,401	48.4
Hotels	1,300	249	17	1	1,567	4.1
Catering	44	32	11	2	89	0.2
Transport	1,638	423	98	25	2,184	5.7
Communications	87	24	9	5	125	0.3
Finances	224	42	30	13	309	0.8
Operations involving real property	3,577	649	143	16	4,385	11.5
Education	275	85	17	1	378	1.0
Health and social care	441	162	129	40	772	2.0
Other	1,363	336	96	17	1,812	4.8
Total by corporate form	29,474	6,658	1,574	280	37,986	100.0

Source: CSB, end of February, 2000.

normal living standard for the owner and family members, rather than profit and business operations as understood by the market economy. For the most part, these are wood processing, farm production processing and light industry plants located in small towns and rural areas.

Regional Distribution

Most of the active companies are located in Rīga (53%) and the other six larger cities of Latvia: Daugavpils, Jelgava, Jūrmala, Liepāja, Rēzekne and Ventspils (for a total of 16%); almost 11% of all companies are located in areas surrounding Rīga, Ogre, Cēsis and Tukums regions. Rīga may be considered the driving force of growth of the private sector within a wider area, even Valmiera city and region (2%). Only 18% of all companies are operating in all other regions, showing a significant imbalance in the distribution of business by areas. The present implementation of regional policy has not shown significant results in evening out these differences.

Such territorial disproportion of business activities may prove to be a future obstacle, delaying development of a higher value added type of business and the

[16] Definition of the Law "About Control of State and Local Government Support to Small Business".
[17] Latvia. Human Development Report. UNDP, Rīga, 1998.

resulting increase of the living standard. The pessimistic mood reigning among the population of Latgale and other less developed areas will result in migration of the labour force, especially among the young and educated, to a more favourable environment. A significant increase in business activities cannot be seen without serious investment in small town and rural infrastructure and education and direct stimulation, persuading educated people to live and work there. The situation could be improved by a targeted and efficiently managed distribution of EU structural funds in less developed regions.

Our analysis also confirms the conclusion that a stable and unchanging SME sector structure has established itself. During the last five years the number of manufacturing companies has not increased and no dynamic sector has emerged in any particular region of Latvia.

Table 11 Classification of Active Companies in Larger Cities and Regions by Number of Employed

City/region	1–9	10–49	50–249	>250	Total	Proportion, %
Cities						
Rīga	15,676	3,411	738	152	19,977	52.6
Daugavpils	1181	248	55	22	1,506	4.0
Jelgava	683	152	38	9	882	2.3
Jūrmala	699	92	32	8	831	2.2
Liepāja	1,047	214	47	9	1,317	3.5
Rēzekne	416	107	33	3	559	1.5
Ventspils	608	171	32	7	818	2.2
Regions						
Alūksne	190	60	9	1	260	0.7
Balvi	164	35	10	1	210	0.6
Bauska	362	89	25	2	478	1.3
Cēsis	677	143	35	4	859	2.3
Daugavpils	118	39	11	1	169	0.4
Dobele	212	61	29	5	307	0.8
Gulbene	234	64	14	1	313	0.8
Jelgava	186	54	17	0	257	0.7
Jēkabpils	441	110	27	2	580	1.5
Krāslava	156	49	14	1	220	0.6
Kuldīga	289	91	17	4	401	1.1
Liepāja	301	62	16	1	380	1.0
Limbaži	338	77	20	4	439	1.2
Ludza	176	54	12	2	244	0.6
Madona	332	101	23	2	458	1.2
Ogre	524	120	21	5	670	1.8
Preiļi	308	504	17	4	383	1.0
Rēzekne	153	32	13	1	199	0.5
Rīga	1,439	337	98	10	1,884	5.0
Saldus	351	77	28	2	458	1.2
Talsi	472	113	32	2	619	1.6
Tukums	481	127	38	1	647	1.7
Valka	254	55	19	6	334	0.9
Valmiera	620	148	30	6	804	2.1
Ventspils	60	28	5	0	93	0.2
Total	29,474	6,658	1,574	280	37,986	100.0

Source: CSB, as at end of February 2000.

SME Development Problems

The increase and growth of SMEs are affected by market opportunities, private initiative, changes in business environment promoting establishment of new companies, access to capital and reforms in the government sector relating to completion of privatization, restructuring of the privatized enterprises and the labour market. In capital and intellectually intensive sectors, SME development is affected also by technology "traditions" and level of sub-sector development, availability of appropriate infrastructure and manufacturing premises, as well as quality of the educational system.

Starting and Developing a Business

The only detailed study of SME operations and development[18] carried out at present shows that lack of starting capital, high taxes and insufficient operating funds are the problems which Latvian business people face when starting operations and which are felt equally by representatives of different regions, cities and sectors. Of the business people polled, 91% admitted that at the beginning of operations they felt a lack of capital and operating funds, 78% of companies were slowed down by high taxes. Unstable and uncertain legislation, and difficulties present at institutions when applying for permits and taking care of registration. These problems are followed by difficulties related to market entry, high competition and ability to sell their production or services, as well as difficulties in finding suitable premises. The matter of premises is most often cited by businesses in the trade and service sector. A serious starting problem is also lack of experienced and trained staff, but less pronounced are difficulties in purchasing equipment and raw materials. Manufacturing and construction companies face problems selling, small demand, and insufficient business information more often than those engaged in the trade and service sector. The study shows that business people do not consider racketeering, corruption and organized crime to be the main problem.

SMEs cited the slow and complicated dealings with government and municipal administration as a serious obstruction to their operations. SMEs found the least accommodating attitude in dealing with the National Revenue Service (this was mentioned as an obstacle by 35% of those polled), municipal services (17%) and Customs (13%). The main difficulty is the slow processing, many necessary visits, unfriendly attitude on the part of civil servants, unpredictable order in reviewing issues and arbitrary interpretation of the laws.

In studying SMEs[19], the main operations of companies were compared during their first year of operations and in 1998. At the very beginning of business operations, trade or emphasis on turnover gained in

Table 12 Main Starting Problems (% indicates the proportion of the problem)

Starting problem	Proportion	Comments
Capital	33%	Limited opportunities to obtain loans, especially in the case of newly established companies
Taxes and institutional environment	29%	SMEs consider the tax burden to be too heavy, changes in taxes are too frequent, one and the same document must be submitted to many institutions, uncertainty and administrative obstacles
Market	17%	No market research has been done, limited choice of consultants in this area
Premises	9%	A specific problem in trade
Labour force	6%	A lack of trained staff proficient in foreign languages, lack of knowledge in selecting staff, lack of suitable and work-oriented people looking for employment in a number of rural areas
Equipment and technologies	4%	Not significant, but 81% of active business people consider their equipment outdated. At present SMEs put their resources in maintaining present equipment rather than updating it
Racketeering and Mafia	2%	Insignificant

Source: FSI study.

[18] T. Tisenkopf etc., How Small Buisnesman feels. Report to government of Latvia, Riga, LU FSI, September 1998.
[19] T. Tisenkopf etc.

trade characterized almost half of all small and medium businesses and confirmed the limited opportunities to make use of comparatively inexpensive and long term capital for their business development, as well as lack of a clearly defined strategy. This shows that those SMEs which represent quick profit and turnover types of business are the most comfortable in the present economic environment. It should be noted, however, that for many companies, trade or services represent a way to accumulate investment funds for other possible types of operations. It is interesting to note that business people do not mention choice of operations as a starting problem. Indirectly, this shows that there are few companies that start an innovative business or are oriented towards a certain market area.

Another study[20], polling two hundred of the largest Latvian exporters, 74% of them SMEs (up to 250 employees), shows that companies with foreign held shares are most oriented towards foreign markets and are able to compete there. They are more productive and need significantly less government subsidized marketing consultations. Furthermore, only 10% of domestic companies use up-to-date marketing methods. It must be noted that 95.5% of Latvian companies use road transport for supplies and deliveries and only 1–2% consider logistics an even remotely important area worth paying some attention to in the future. Two main obstacles which, according to businessmen, obstruct increased export, are lack of operating funds (54.5%) and insufficient information on available markets (47.5%). An indirectly important problem obstructing growth are administrative obstacles, especially emphasizing Customs procedures and delays in returning VAT. Only 20% of those polled believe that Customs procedures are not a problem for them. Possibly, if companies were provided adequate information on legislation, foreign markets, available support and administrative procedures, many of the present problems might be resolved. Company ability (33%) and desire to use global internet network to obtain this information (12%), is increasing.

The FIAS study[21] emphasized the frequent changes in tax legislation, time consuming and complicated registration, immigration, building, property and inspection procedures, and inconsistency in Customs and border crossing procedures as important factors slowing down business operations.

In sum, polls carried out in different areas show similar obstacles to SME development and that in Latvia, these obstacles do not differ very much from the obstacles in other countries in transition. More significant difference lies in the fact that in the Eastern European countries (the Czech Republic, Poland, Hungary), polls also mention lack of qualified labour force and technology as an important obstacles. This is borne out by a poll of exporters, which shows that the largest part (65%), also large companies, do no research at all, and in 23% of companies research is done by not more than five people. It follows that in Latvia, SMEs represent sectors where demand for research results is not necessary.

Most businessmen polled in the above mentioned studies confirm that the economic environment is gradually improving, demand and purchasing power, both locally and nationally, is increasing, but at the same time mentioning that competition, too, is increasing. If the attitude of business people to the burden of high taxes is traditional, it should be noted that during the past two or three years the relationship between business and government and municipal institutions has not changed, nor has the efficiency of organizations which support the growth of SMEs improved.

Lack of Financial Resources

The International Finance Corporation study[22] carried out in 1998 mentions that the most important problem faced by SMEs in Latvia is the lack of financial resources. Access to financial resources is limited by the differing policies of banks towards SMEs and the unrealistic security demanded by the banks. Although there are several programmes promoting development of SMEs, due to lack of resources, they seldom touch on the most important issue – access to funding and investment. Follow-up shows[23] that at present, procedures demanded by banks are complicated and business people are asking for simplified access to financing in the future. Newly established companies are seldom able to provide safe security, their credit history being insufficient, and interest rates offered by the market being acceptable to trade SMEs only.

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20 Priorities of Latvia's Enterprises and Major Problems in Their External Economic Activities. Rīga, LAA & RBI, 1999.
21 Latvia. Administrative Barriers to Investment. FIAS & PB, December 1998.
22 International Finance Corporation, Interventions in the Baltic and Polish SME sectors, December 1998, LarCon Consortium.
23 Latvia. Human Development Report. UNDP, Rīga, 1998.

Since the real property market is not active and for the most part it is difficult to determine the market value of a real property offered as security by SME, it adds to the risk of a loan to SME and newly established companies. For this reason, commercial banks set higher guarantee requirements (as high as 120–150%) and credit risk surcharges for SMEs and orient themselves to large clients whose service costs are comparable to unprofitable small projects, or companies having a long credit history.

Accounting done in small and medium businesses is often unprofessional, as their auditing systems are undeveloped throughout the country, and frequently even licensed auditors include in their reports conclusions in favour of the company paying their fees. Often the quality of business plans prepared by a company is not high and information provided does not permit proper risk evaluation. The low management level of SMEs does not persuade the banks and causes additional increases in loan interest rates.

Only a few banks have prepared and confirmed a long term operational strategy, which includes a policy of lending to SMEs. SMEs do not need large loans. As a rule, servicing of SMEs takes place in several stages. Loans are paid out in small amounts, confirming that previous amounts have been handled properly and repaid before the next pay-out. Such development holds risk for the small businessman, too, because often all funds are used to develop a product or manufacturing, failing to include financing for getting their production to market. Each such stage begins with a negative cash flow and the company reaches stability only when their sales figures reach costs invested in the production of goods or development of production. This situation could be improved considerably by introducing an efficient risk insurance or guarantee system.

A general summary of the availability of financial resources is shown in Table 13.

According to the FSI study of SMEs, during 1997–1998 small and medium businesses showed a tendency to grow, confirmed by turnover, profit, increased employment, and growth of sales markets, regardless of the company's size or location. As a result of the limited access to financing, SMEs develops by ploughing back their profit in business development. Of all SME 50% invest in their development themselves, and in 15% of cases, amounts of the company's capital investment was in excess of 10% of turnover. Investment is made mainly by companies engaged in industry. Of all SMEs 65%, produce goods for the domestic market. SMEs oriented towards export are mainly concentrated in Rīga. The main source of starting capital prior to 1997 was the owners' own savings and loans from family or friends.

It must be concluded that factors slowing down SME development are lack of funds, limited opportunities for obtaining loans (high interest rates, weak guarantee system, lack of security), lack of business experience, insufficient knowledge of markets, various administrative obstacles (company registration and receiving necessary permits, licensing, the changing report system), frequent changes in legislation and inconsistency in the application of laws and regulations, and lack of premises.

Table 13 A Summary of Availability of Financial Resources to SME

Financial resources	New companies (1–9 employees)	Small companies (10–24 up to 3 yrs)	Small companies (10–24 more than 3 yrs)	Medium companies
Short term	None	Partial	Possible	Possible
Long term	None	None	Partial	Possible
Guarantees	None	None	Partial	Possible
Export subsidies	None	None	Partial	Possible
Interest subsidies	None	Partial	Partial	Partial
Investment	None	None	Partial	Partial

The Legislative System

A General Description of the Legislation

In Latvia, each year an average of about 250 new laws are enacted and 350 Cabinet of Ministers Regulations come into force. However, the fact that the number of legislative acts is increasing too rapidly causes intermultiplicity, ambiguity, and many internal contradictions. Consequently, uncertainties arise regarding application of legal norms. Not enough attention is given to mechanisms for compliance with legislative acts and the necessity to assess the costs of their introduction and implementation. The weakest links are the contradictory and complicated clarification of normative acts and instructions issued by government or municipal institutions in charge, which frequently contradict legislative norms or normative documents of the CM.

The Administrative Process

Most of the problems which arise when government or municipal civil servants unprofessionally or even maliciously apply legal norms could be prevented by an efficient national legislation of the administrative process. Such legislation should provide physical and legal persons whose interests have been affected by a specific decision of a civil servant or institution, with the opportunity to appeal such a decision either to a higher authority or the court. At present the law provides that any application or request made by a person to government or municipal institution must be reviewed within 15 days, but this deadline may be extended to a month if the matter necessitates a request for additional information. In reality, practically all matters are reviewed in a month. And, in the case of a negative decision, the affected person may submit a complaint within a month to a higher authority whose decision in turn may be appealed in court. In certain areas the law provides for shorter deadlines (for example, decisions of immigration authorities must be appealed within 10 days). Unfortunately, the case load of the courts is such that it results in a total inability to observe any procedural deadlines for hearing cases. From the standpoint of business people, this is important, not as much in resolving civil matters (which are a long and complicated process anywhere in the world), as in cases when decisions of administrative institutions are appealed in court. Although the Civil Code provides that the courts must hear administrative complaints within 10 days after preparing the case for hearing, in reality these deadlines are totally ignored and cases are heard approximately within a year. Thus, in the event of illegal actions on the part of administrative institutions, a company has virtually no opportunity to defend its interests because the matter in question is no longer current. In fact this causes an outright inequality between the government and a business. For a business defaulting on any deadline (tax payment, submission of documents or obtaining a permit) may result in fiscal or administrative sanctions, whereas ignoring deadlines on the part of the government in reviewing complaints and submissions of people causes no unfavourable consequences for the government and are not even considered a justification in the event the person in question misses something because of it. Thus, in order to provide a real equality between the government and the corporate world in the event of resolving a dispute, it is necessary to determine shorter deadlines for reviewing matters in administrative institutions and ensure a rapid and efficient hearing of cases in courts.

Establishing and Registering Private Property

The property reform started in 1991, when the laws on returning buildings and land to their legal owners (in accordance with the situation in 1940) or their heirs were enacted. Although for the most part the principle of renewal of ownership rights was observed, the laws provided for a complicated and relatively expensive procedure to renew ownership rights and legally register them. The process is regulated by some 15 various Acts, involving at least 8 different institutions. Although by 1997 $^{2}/_{3}$ of all real property (about 5,000 holdings in total) were returned to private persons, only about 22% were registered with the Land Books. For this reason, the real property market is still undeveloped. Although a large number of real properties are privately owned, a mortgage lending system is not developing, a fact which in a situation where cash savings are limited, is a necessary condition precedent for business development. Speeding up ownership registration is one of the main conditions precedent to activate this market.

Business Legislation

Regulating Business

In Latvia, business operations are mainly regulated by a blanket law, "On Entrepreneurship", which was passed by the Supreme Council of the RL on September 26, 1990. The Supreme Council passed this law at first reading barely three months after renewal of independence, thus confirming its importance to the national economy. The existence of this blanket law facilitated the adoption of several legislative acts regulating various forms of business, as well as conditions for their implementation. Once the law "On Entrepreneurship" was enacted, any business whose corporate form did not comply with the provisions of the law had to be quickly re-organized or had to terminate its operations.

Prior to the adoption of the law "On Entrepreneurship" mainly businesses whose registration was permitted by State administrative acts operated. Since 1987 new trends have emerged and the co-operative movement has started. Resolutions of the Council of Ministers of the Latvian SSR regulated the areas in which operations were permitted, such as:

- "On Establishing Co-operatives for the Production of Consumer Goods" (No. 69, 10.03.1987);
- "On Individual Work" (No. 128, 23.04.1987);
- "On Farm Holdings" (No. 326, 04.10.1988)
- "On Collective Gardening and Growing of Produce" (No. 363, 04.11.1988), and others.

Special procedures were set for joint ventures. Until 1989 all joint ventures were registered in Moscow. Later their establishment was determined by orders of the Council of Ministers of the Latvian SSR. In this way several well known companies were established, such as:

- "MONO OL" (Order No. 104, 07.04.1989),
- "MAN TESS" (Order No. 163, 08.06.1989),
- "Inta Union" (Order No. 183, 23.06.1989).

After the renewal of independence, in Latvia personal freedom was ensured when choosing individual or collective business forms or joining of people from Latvia and other countries to establish new companies.

The law "On Entrepreneurship" provides organization of business in the Republic of Latvia in general terms, based on the diversity of ownership forms and equal rights. The law states forms of business, the main principles of their establishing, organizing and registration.

During the eight years since the law was enacted, it has been changed several times.

Table 14 Changes to the Law "On Entrepreneurship" and Their Effect on SMEs

Law	Article	Changes	Effect
Law of the Supreme Council of the Republic of Latvia "On Amendments to the Law of RL of September 26, 1990 "On Entrepreneurship" (14.05.1991)	4	Provides for equal rights of all businesses;	+
	5	Defines types of business and companies;	+
	7	Provides that the rights of a legal person come into effect at the time of registration with the Company Register of RL;	+
	8	Defines status of representative offices by providing that subsidiaries and representative offices of companies registered in Latvia do not hold the status of a legal person;	+
	10	Defines signing of collective labour agreements;	+
	13	Provides that the list of forms of business is final;	+
	16	Limits forms of permitted State and municipal companies;	+
	25	Defines compliance of business forms with requirements of relevant laws;	+
	27	Defines provisions on mandatory business insurance in other laws;	+ –
	31	Provides that business operations limited by a relevant law may be started after submitting a special licence to the Company Register of RL; provides that the Company Register of RL may not demand other documents not provided by law;	– +

Law	Article	Changes	Effect
	32	■ Extends types of business operations requiring a licence; provides a general procedure for obtaining licences; lays down the minimum basic capital required for banks, insurance companies and pawn shops;	+ –
	33	■ Lays down additional requirements for managers and owners of businesses; entitles the Committee for Environmental Committee and institutions of the Council of Ministers to suspend operations of companies violating the provisions of this law;	+ –
	34	■ Defines suspension of business operations; introduces a norm that forbids termination of a business in order to reorganize it; introduces a norm permitting payment of debts by selling assets at tender or transferring to creditors.	+ –
Law of the Supreme Council of the Republic of Latvia "On Amendments to the Law of RL of September 26, 1990 "On Entrepreneurship" (12.09.1992)	1	■ Provides that issues concerning nonprofit organizations are regulated by the law of 17.12.1991;	+
	2	■ Defines application of the law to institutions whose basic function is not business;	+
	3	■ Defines operations of the Economic court, which is replacing arbitration;	+
	8	■ Defines that subsidiaries and representative offices are registered after submitting approved Founding Laws to the Company Register of the RL;	–
	12	■ Provides that bookkeeping must be kept as provided in normative (change from legislative) acts;	+ –
	14	■ Supplementing that a fishery, too, may be a one-owner business;	+
	15	■ Provides a procedure for naming individual businesses, farm holdings and fisheries; supplements that operations of the aforesaid business must observe provisions of the special law enacted on 08.01.1992;	+
	16	■ Defining by changing terminology;	+
	17	■ Supplements regarding businesses (companies) of public or religious organizations;	+
	22	■ Provides a form for name of limited liability companies (SIA);	+
	25	■ Supplements that establishing and operations of companies of foreign nationals is regulated by a special law enacted on 05.11.1991 which provides for relief, but a limit on investment restricts access by SME;	+ –
	26	■ Defines the role of the Government in regulating business operations;	+
	29	■ Defines facility for resolving disputes; Economic court replaces arbitration;	+
	32	■ Extends the list of types of business requiring a licence for their operations;	–
	33	■ Provides additional requirements for managers and owners of businesses;	–
		■ Entitles State and municipal institutions to suspend operations of a company violating provisions of this law;	–
	34	■ Defines reasons for terminating a company by order of the Economic court, which replaces arbitration;	+
	35	■ Provides that a company may be reorganized following a resolution of the owner or an authorized institution;	+
	36	■ Supplement providing that income gained from unregistered business operations or business operations without a licence is paid to the National budget;	+ –

Law	Article	Changes	Effect
Law of the Supreme Council of the Republic of Latvia "On Amendments to the Law of RL of September 26, 1990 "On Entrepreneurship"" (12.01.1993)	31	■ Supplement providing that a new document is needed (regarding legal address) when registering a business (company);	+ –
	32	■ Limits unlicensed operations with special items (gas pistols, balloons etc.); extends the list of types of business requiring a licence.	+ –
Law of the Supreme Council of the Republic of Latvia "On Amendments to the Law of RL of September 26, 1990 "On Entrepreneurship"" (23.02.1993)	32	■ Extends the list of types of business requiring a licence;	–
	34	■ Supplement providing that operations of a business or company engaged in unlawful operations or operating without a licence may be terminated by court order;	+ –
	35	■ Supplement providing for reorganization of a company by court order following a demand by the monopoly supervisory institution.	+
Law of the Supreme Council of the Republic of Latvia "On Amendments to certain legislative acts of the RL related to the Establishment of the National Land Service" (27.04.1993) as it pertains to the following Articles of the Law "On Entrepreneurship"	32	■ Amendments providing a division of authority such that for operations relating to land, licences shall be issued by the National Land Service; a supplement providing that a licence is required for land surveys.	+ –
Law of the Supreme Council of the Republic of Latvia "On Amendments to some Laws of RL concerning the Safe Storage of Personnel Documents" (11.05.1993) and how these relate to the following Articles of the Law "On Entrepreneurship"	34	■ Supplements providing conditions of safekeeping and storage of documents following termination of a company;	+
	35	■ Supplements requiring the manager of a business (company) to ensure safekeeping of documents of a reorganized company.	+
Law of the Supreme Council of the Republic of Latvia "On Amendments to the Law of RL of September 26, 1990 "On Entrepreneurship"" (18.05.1993)	32	■ Extends the list of types of business requiring a licence; increases the minimum of basic capital for shareholding companies banks, insurance companies and pawnshops; supplements that licences for insurance operations and insurance agents are issued under a procedure provided by the special law enacted on 12.01.1993.	+
Law of the Saeima of the Republic of Latvia "On Amendments to the Law "On Entrepreneurship"" (24.02.1994)	34	■ For the sequence of repaying company debts; supplements a definition of requirements providing for legal labour relations and that claims for compensation of injuries shall be paid regardless when the right of claim had originated.	+ –
Law of the Saeima of the Republic of Latvia "On Amendments to the Law "On Entrepreneurship"" (15.06.1994); at the same time CM Regulations No. 14 (11.01.1994), 77 (14.04.1994), No. 82 (14.04.1994) become null and void.	32	■ Defines wording of some Clauses and Paragraphs, including changing the words "Council of Ministers" to read "Cabinet of Ministers" and "Supreme Council" to "Saeima"; forbids acceptance of deposits without a licence from the Bank of Latvia; extends the list of types of business requiring a licence; defines that the amount of basic capital provided by the law for banks, exchanges, pawnshops and insurance companies shall be the founding equity capital.	+ –
Law of the Saeima of the Republic of Latvia "On Amendments to the Law "On Entrepreneurship"" (29.03.1995); at the same time CM Regulations issued under Article 81 of the Constitution No. 135 (19.07.1994), 153 (19.07.1994), No. 170 (30.08.1994) become null and void.	32	■ Deletes the list of types of businesses requiring a licence, providing division of authority between institutions authorized by the Cabinet of Ministers, the Bank of Latvia, municipalities and professional associations, noting that the Government is entitled to determine a monopoly for some types of business; licences already issued shall remain in effect.	+ –
Law of the Saeima of the Republic of Latvia "On Amendments to the Law "On Entrepreneurship"" (02.11.1995);	34	■ Supplement providing for some advantages to suppliers of agricultural products in satisfaction of claims to companies in liquidation.	+ –

Law	Article	Changes	Effect
Law of the Saeima of the Republic of Latvia "On Amendments to the Law "On Entrepreneurship"" (19.09.1996); at the same time CM Regulations passed under Article 81 of the Constitution No. 129 (10.04.1996), become null and void.	15	■ Provides for liability of an individual business owner with all his/her property;	+ –
	34	■ Defines that liquidation shall be carried out in accordance with the new law on insolvency of businesses and companies, deleting from the Article the list of how claims are satisfied; supplements that in certain cases liquidation may be carried out also by resolution of the National Revenue Service;	+ –
		■ Provides a maximum deadline for liquidation in six months except in cases of a court-appointed liquidator.	
Law of the Saeima of the Republic of Latvia "On Amendments to the Law "On Entrepreneurship"" (22.05.1997); at the same time CM Regulations passed under Article 81 of the Constitution No. 15 (10.01.1997), 136 (07.04.1997), become null and void.	34	■ Supplements that business operations are also terminated if the basic capital does not comply with the requirements of the law; supplements a definition of creditors' requirements and claims;	+
	34.1	■ Supplements the Law with a new Article stating special cases when State or municipal enterprises (companies) may be struck from the Company Register of RL, providing under the transitional provisions expiry of the effect of the Article on 31.12.1998;	+
	34.2	■ Supplements the Law with a new Article providing the procedure for liquidating companies whose basic capital does not comply with the requirements of the law.	+
Law of the Saeima of the Republic of Latvia "On Amendments to the Law "On Entrepreneurship"" (04.12.1997); at the same time CM Regulations passed under Article 81 of the Constitution No. 274 (05.08.1997), becomes null and void.	32	■ Defines wording of the Clause by deleting the words "financial and lending operations" and "restrictions relating to banks", defining same as restrictions related to operations of credit institutions;	+
	33.1	■ Supplements the Law with a new Article regulating matters concerning the establishment, registration and sale of commercial pledges and providing for four institutions for registration of pledges;	+
	35	■ Supplement providing that the new company resulting from merging or annexation of businesses (companies) shall assume all the rights and obligations of the merged or annexed companies; defines provisions concerning the dominant position of businesses (companies) in the market;	+
	Transitional provisions	■ Determine that liquidation of agricultural statute provisions companies is completed and debts paid as provided by the CM and in accordance with the list approved by the CM.	+ –
		Total "+"	29
		Total "–"	4
		Total "+ –" or "– +"	20

Conclusions

During the eight years since the law "On Entrepreneurship" was enacted, it has been changed considerably. Important amendments and supplements are related to licensing of business operations, satisfaction of claims, re-organization and liquidation The extension of types of business operations requiring a licence had the most negative effect on SME operations. However, all in all the positive assessment of changes to the blanket law far outweighed the negative.

Many of the changes to the articles were considered positive and negative, which means that along with the positive government regulation introducing clarification of a certain issue, business operations of SMEs are restricted at the same time. A negative effect on SMEs is ascribed to Acts granting exceptional status or individual approach to specific companies, leaving the problems of other similar companies to their own resources.

Until adoption of a law regulating insolvency and bankruptcy cases, the law on Entrepreneurship provided the procedure for satisfying creditors' claims. Experience showed later that it was the matter of satisfying creditors' claims, especially in the case of physical persons, that was at the centre of public attention.

Business people, employees or shareholders of companies had difficulty understanding the new legislation. Later, it was difficult to follow all the changes to the laws, various regulations, and provisions. By attempting to introduce some kind of order, new normative acts were introduced which in turn made the procedure for establishing businesses even more difficult. Licensing and other restrictions obstruct business operations not only by the special procedures but also by wasting time and money needed to reach their goal.

A positive factor is the drafting of the Commercial Law. This Law will replace some fifteen various legal acts adopted since 1990 in the area of commercial rights and will serve in the future as a collection of normative acts related to business operations. The number of business forms will be reduced (from twelve to five), relations between areas of private rights and commercial rights will be defined, existing norms regulating business operations aligned preventing contradictions and introducing a single terminology and principles of theory in accordance with EU requirements. Business people will find it easier to understand and choose the type of business form most suited to their future operations.

At the same time a draft law on concessions is being written which will regulate ways of how a private business may become involved in financing and using different objects of infrastructure.

Licensing and Restrictions of Business Operations

At the time of adopting the law "On Entrepreneurship", its Article 32 listed those types of business which required a licence. Pursuant to this, the Council of Ministers passed Resolution No. 130 on May 6, 1991 "On the Procedure for Issuing Special Permits (Licences) to Perform Certain Business Operations or Establishing Certain Businesses (Companies)". This Resolution provided for a division of authority between institutions, providing which Ministries issued licences for which types of businesses, on Licensing Commissions and their rights and obligations. However, 3 months later this Resolution was replaced by Resolution No. 203 adopted by the Council of Ministers on August 5, 1991 under a similar title.

Since during the following period of time the law "On Entrepreneurship" regularly extended the number of types of businesses requiring a licence, the Resolutions concerning the procedure for issuing licences were supplemented. In 1995, when the list of types of businesses requiring a licence was deleted from the Law "On Entrepreneurship", the Resolution providing a procedure for issuing licences was replaced by extended regulations including both the list of business types requiring a licence as well as the procedure for issuing such licences.

Table 15 Changes in Acts Relating to Licensing and Their Effect on SME Operations

Act	Clause	Changes	Effect
CM Resolution No. 203 "On the Procedure for Issuing Special Permits (Licences) for Performing Specific Types of Business Operations or Establishing Businesses (Companies)" (05.08.1991)	All	■ A new resolution replacing No. 130 of 06.05.1991; ■ Adopted because of amendments to the Law "On Entrepreneurship", including extension of the list of types of businesses to 28.	+ – –
CM Resolution No. 123 "On Supplementing Resolution No. 203 of the CM of RL Passed on August 5, 1991 "On the Procedure for Issuing Special Permits (Licences) for Performing Specific Types of Business Operations or Establishing Businesses (Companies)"" (08.04.1992)	1.1 2	■ Supplements that the Ministry of Finance is authorized to issue Licences for operation of Exchanges; ■ Supplements a provision describing the Commission for assessing issuing of licences and a provision that the licence must be received prior to registering the Exchange with the Company Register of RL.	+ – + –
CM Resolution No. 499 "On the Procedure for Issuing Special Permits (Licences) for Performing Specific Types of Business Operations" (23.11.1992)	All	■ A new Resolution replacing Resolution No. 203 adopted 05.08.1991 and the supplement to it of 08.04.1992; ■ The Law "On Entrepreneurship", extending the list of companies requiring a licence to 49, as also shown in the CM Resolution; ■ The Resolution provides that operation of businesses conflicting with Resolutions passed is forbidden and shall be terminated immediately, thus strengthening the administrative influence on business operations in general.	+ – – –

Act	Clause	Changes	Effect
CM Resolution No. 70 "On Supplementing Resolution No. 499 of the CM of RL passed on November 23, 1992 " (11.02.1993)	4	■ A supplement providing that a fee of $ 1,000 be paid for issuing a licence to purchase and sell precious metals, precious stones and their products outside the territory of the RL.	–
CM Resolution "On Amending Resolution No. 499 of the CM of RL passed on November 23, 1992" (04.03.1993)	1.5	■ New wording cancelling territorial restrictions for operations involving precious metals and precious stones;	+
	1.13	■ Deletes article because of new wording in Article 1.5;	+
		■ Simultaneously provides that licences for operations involving precious metals and precious stones must be reprocessed;	–
		■ Resolution No. 70 of CM of 11.02.1993 is cancelled.	+
CM Resolution No. 148 "On Amending Resolution No. 499 of the CM of RL passed on November 23, 1992 " (23.03.1993)	4	■ New wording provides that applications for a licence must be accompanied by confirmation of registration as a taxpayer and full payment of all moneys outstanding to the National budget;	–
		■ The article is supplemented with a new paragraph recommending that municipal institutions, the Bank of Latvia and professional associations may review applications for licences as provided by the Government.	–
CM Resolution No. 163 "On Supplementing Resolution No. 499 of the CM of RL passed on November 23, 1992 "(29.03.1993) CM Resolution No. 266 "On the Procedure for Issuing Special Permits (Licences) for performing of specific types of business operations"" (27.05.1993)	1.14	■ A new clause providing that issuing licences for sale and public showing of films and videos are issued by the Ministry of Culture.	–
CM Resolution No. 266 "On the Procedure for Issuing Special Permits (Licences) for performing of specific types of business operations"" (27.05.1993)	All	■ A new resolution replacing Resolution No. 499 adopted on 23.11.1992 and all amendments to it;	–
		■ Determines institutions issuing licences for certain types of business operations.	+ –
CM Resolution No. 350 "On Supplementing Resolution No. 266 of the CM of RL passed on May 27, 1993" (02.07.1993)	1.5.5	■ Supplementing that the Ministry of Finance shall issue licences for organizing any kind of lotteries, raffles and money games;	+ –
		■ Area of operations requiring licensing, but also extending the list of types of business operations requiring a licence.	+ –
CM Resolution No. 100 "On Amending Resolution No. 266 of the CM of RL passed on May 27, 1993" (10.05.1994)	1.4.3	■ Wording of this clause is supplemented by a provision that a licence is required for selling and manufacturing of pyrotechnic material and weapons and providing pyrotechnic services.	+ –
CM Resolution No. 107 "On Amending Resolution No. 266 of the CM of RL passed on May 27, 1993" 30.03.1994)	1.3.4	■ A new subclause providing that the Ministry of Transport shall issue licences for retail operations involving motor vehicles and trailers.	–
CM Resolution No. 420 "On Amending Resolution No. 266 of the CM of RL passed on May 27, 1993" (14.09.1994)	1.3.2	■ Supplementing the existing clause with a provision that the Ministry of Transport shall also issue licences for providing postal services.	–
CM Resolution No. 36 "On Amending Resolution No. 266 of the CM of RL passed on May 27, 1993 "On the Procedure for issuing special permits (licences) for performing operations of certain types of businesses" (14.02.1995)	1.17	■ Supplements the existing clause by providing that the National Plant Protection Station shall issue licences for sale of plant protection agents.	–
CM Resolution No. 176 "On Amending Resolution No. 266 of the CM of RL passed on May 27, 1993" (20.06.1995)	1.16.9	■ A new subclause providing that a licence is required for shipment of ethyl alcohol;	+ –
	1.16.10	■ A new subclause providing that a licence is required for shipment of alcoholic beverages.	+ –

Act	Clause	Changes	Effect
CM Resolution No. 40 "On Issuing Special Permits (Licences) (26.10.1993)	1.16	■ Provides that the Ministry of Economy shall issue licences to import alcoholic beverages and tobacco products, purchase of ferrous and nonferrous metals within the RL and operations involving privatization certificates deleted.	+ –
CM Resolution No. 19 "On Issuing Special Permits (Licences) for operations involving securities and privatization certificates" (01.03.1994)	1.15.6	■ A new Subclause providing that a licence is required for operations involving securities.	+ –
		Total "+"	4
		Total "–"	12
		Total "+ –" or "– +"	10

Conclusions

The CM Resolution No. 203 "On Procedures for Issuing Special Permits (Licences) for Performing Certain Types of Business Operations and Establishing Certain Types of Businesses (Companies)" (05.08.1991), and CM Resolution No. 266 adopted on May 27, 1993 "On Procedures for Issuing Special Permits (Licences) for Operation of Certain Types of Business" are considered to be rather more negative than positive. During a short period of time two resolutions totalled more than ten amendments affected SMEs, increasing the number of types of businesses requiring a licence.

To replace CM Resolution No. 266 (adopted May 27, 1993 "On Procedures for Issuing Special Permits (Licences) for Operation of Certain Types of Business and Establishing Certain Types of Businesses (Companies)"), the CM passed Resolution No. 321 on October 31, 1995 ("Regulations on Restriction of Business Operations"). This is linked to the fact that on March 29, 1995 the law "On Entrepreneurship" was amended to delete the list of businesses requiring a licence. This list was then included in CM Regulations providing that 162 types of businesses require a licence, 20 of which are licensed by professional associations and corporations. Previously, when types of businesses requiring a licence were regulated by the Law, it was difficult to make procedural changes to the Law. However, after the new revisions to the Law "On Entrepreneurship", the government had extensive opportunities to change or supplement the types of businesses requiring a licence as soon as such a need arose. This approach shows that the government desires to have maximum control over business and show its all inclusive influence. From the standpoint of business such an approach is unfavourable because it does not promote conditions for quick implementation of initiative. Every new obstacle is a factor slowing down establishing of SMEs. People who wish to establish a SME attempt to comply with all procedures and collect all documents themselves because of their limited funds. The very title of the new CM Regulations shows the aim of these Regulations – not to promote but to restrict business operations.

Table 16 Amendments to "Regulations on Business Restrictions" and Their Effect on SME Operations

Act	Clause	Changes	Effect
CM Resolution No. 356 "Amendments to Regulations No. 321 adopted by CM on October 31, 199O "Regulations on Business Restrictions" (21.11.1995)	3.18 3.19	■ Amending wording; ■ Increasing the number of types of business requiring a licence.	+ – –
CM Resolution No. 361 "Amendments to Regulations No. 321 adopted by CM on October 31, 1995 "Regulations on Business Restrictions" (21.11.1995)	3., 6.3	■ Increasing the number of types of businesses requiring a licence.	–
CM Resolution No. 168 "Amendments to Regulations No. 321 adopted by CM on October 31, 1995 "Regulations on Business Restrictions" (14.05.1996)	3.18 3.4.10 3.4.11 3.8.3 5.8–9	■ Defining wording of a normative concerning oil products; ■ Deleting the listed clauses, thus reducing the types of business.	+ +

Act	Clause	Changes	Effect
CM Resolution No. 216 "Amendments to Regulations No. 321 adopted by CM on October 31, 1995 "Regulations on Business Restrictions" (20.06.1996)	3.4.20 3.4.21	■ Reduces the number of types of businesses requiring a licence (transit of alcohol);	+
	3.4.23 3.4.24 3.4.25 3.4.26 3.4.27	■ Five new clauses increase the types of businesses requiring a licence.	–
		Total "+"	3
		Total "–"	3
		Total "+ –" or "– +"	1

Regulation No. 321 passed by CM on October 31, 1995 were in force for a little more than a year, when they were replaced by Regulation No. 434 adopted by CM on November 19, 1996 "Regulations on Licensing Certain Types of Business". These regulations, compared to previous ones, reduced the types of business requiring a licence (to 115, not including certification of professional associations). Conclusive issues, too, show a positive trend to analyzing business operations and harmonizing these with EU Directives and international conventions. The aforesaid regulations are replaced by CM Regulation No. 348 passed on October 7, 1997, "Regulations on Licensing Certain Types of Business".

Table 17 The Effect of Changes in "Regulations on Licensing Certain Types of Business" and "Regulations on Licensing Certain Types of Business" on SME Operations

Act	Clause	Changes	Effect
CM Resolution No. 470 "Amendments to Regulations No. 434 adopted by CM on November 19, 1996, "Regulations on Licensing Certain Types of Business" (24.12.1996)	5.1.1, 6.29, 36.1	■ Providing a division of authority, removing from town, city and parish (*pagasts*) municipalities the right to issue licences to retail tobacco products and entrusting same to the Ministry of Finance and institutions under its jurisdiction, simultaneously providing that previously issued licences must be re-registered at the Excise Goods Service.	+
CM Resolution No. 104 "Amendments to Regulations No. 434 adopted by CM on November 19, 1996 "Regulations on Licensing Certain Types of Business" (18.03.1997)	36.1	■ Extending the deadline for re-registration of licences provided in clause 6.29 by two months.	+
CM Resolution No. 204 "Amendments to Regulations No. 434 adopted by CM on November 19, 1996 "Regulations on Licensing Certain Types of Business" (03.06.1997)	6.5	■ Deleted (Exchange operations);	+
	6.8	■ Deleted (Sworn auditor operations);	+
	6.30	■ A new clause, providing that a licence is required to import fuel for the manufacture of other goods (except fuel) without the right to sell the imported fuel to other persons;	+ –
	6.31	■ A new Clause providing that a licence is required for manufacture and wholesale of fuel.	+
CM Resolution No. 239 "Regulations on the Use of Underground Natural Resources" (08.07.1997)	12.1, 12.2	■ Both clauses are deleted from "Regulations on Licensing Certain Types of Business" and 12.2 due to entrusting the review of these issues to the National Geology Services.	+ –
CM Regulations No. 348 "Regulations on Licensing Certain Types of Business" (07.10.1997)	All	■ A new regulation providing that the number of types of business requiring a licence is reduced to sixty eight (deleting more than forty types of business from the list requiring licence).	+
CM Resolution No. 424 "Amendments to Regulations No. 348 adopted by CM on October 7, 1997 "Regulations on Licensing Certain Types of Business" (16.12.1997)	12.5	■ A new clause providing that a licence is required for operations involving international tourism.	–

Act	Clause	Changes	Effect
CM Resolution No. 72 "Amendments to Regulations No. 348 adopted by CM on October 7, 1997 "Regulations on Licensing Certain Types of Business" (03.03.1998)	13.5	■ Defining assortment of imported sugar;	+
	19	■ Defining procedure for establishing Licensing Commissions, providing that no Licensing Commission need be appointed if a special procedure for issuing import licences is provided;	+ –
	35.1	■ A new clause having two subclauses regulating provision of information on the process of using the licence for importing sugar;	+
	35.2	■ A new clause providing that in the event of cancelling a sugar import licence application for a new licence may not be submitted for one year.	+ –
CM Resolution No. 186 "Amendments to Regulations No. 348 adopted by CM on October 7, 1997 "Regulations on Licensing Certain Types of Business" (19.05.1998)	6.3	■ Extends list of business operations requiring a licence in the area of precious metals, precious stones and their products by providing that a licence is required to accept as a pledge and safeguard them.	+
CM Resolution No. 400 "Amendments to Regulations No. 348 adopted by CM on October 7, 1997 "Regulations on Licensing Certain Types of Business" (06.10.1998)	6.2	■ Provides that a licence is needed for insurance companies providing services of an insurance agent.	–
CM Resolution No. 451 "Amendments to Regulations No. 348 adopted by CM on October 7, 1997 "Regulations on Licensing Certain Types of Business" (08.12.1998)	15.4	■ Provides that a licence is needed to supply heat, electric power, natural gas and liquid gas; in the event business operations are performed on the scope provided by the Energy Law; the scope of application is reduced.	+
CM Resolution No. 496 "Amendments to Regulations No. 348 adopted by CM on October 7, 1997 "Regulations on Licensing Certain Types of Business" (29.12.1998)	6.10	■ A new clause providing that a licence is needed for reimbursement to foreign nationals (physical persons) of VAT paid on goods purchased in Latvia and exported;	+ –
	7.10	■ Deleted, thus reducing the number of businesses requiring a licence;	+
	41.1	■ A new clause providing that clause 6.10 comes into effect on July 1, 1999 (when 6 months have passed after the norm has come into effect).	+
		Total "+"	11
		Total "–"	3
		Total "+ –" or "– +"	5

Conclusions

Although regulations regulating types of business requiring a licence were changed in 1995 and 1996 also in 1997, the government has taken a number of positive steps in order to reduce their effect on private business. During the past three years the number of types of businesses requiring a licence has decreased considerably (to sixty eight). Issues related to practice of individual specialists (doctors, lawyers, auditors, assessors, etc.), have been taken over to a certain point by professional associations. Thus the total government influence has decreased and business people may start their intended type of business without wondering if the government will grant them a licence or not. It is to be hoped that government institutions will look at types of business requiring a licence and withdraw from regulating the types where government or municipal interference is not required (for example, international tourism, retail of motor vehicles, etc.).

It is also necessary to simplify the procedure for issuing licences. Matters within the jurisdiction of government institutions must be taken care of by the institutions themselves, rather than using the company applying for the licence as an intermediary for obtaining information. For example, information on annual reports, financial statements, bank accounts and tax payment may be obtained from the National Revenue Service. If an institution issuing the necessary licence, such as the Excise Goods Service, need information at the disposal of the NRS, this information is available within minutes using the computer network, and the

applicant for a licence need only submit an application completed according to a given sample.

A situation where there are no types of businesses which require a licence is not possible, because in many cases licensing is necessary to protect the public and the consumer (for example, manufacture and sale of weapons, manufacture of drugs, etc.). However, it is desirable that these functions be entrusted to professional or regional institutions, because it is easier and more practical to take care of such matters on site. It would also increase local revenue (for example, licences for construction companies could be issued by a professional organization, licences for management of shipping waste could be issued by the appropriate port administration or the Latvian Port Council in accordance with the criteria provided by government institutions, etc.). All that has been achieved in order to regulate licensing of businesses, as affecting SMEs, can be considered favourably.

Corporate Forms

According to their legal status, all legally permitted corporate forms in Latvia may be classified according to their legal status, degree of material liability and the number of owners (partners). The existing forms are shown in the following table.

In addition to the aforementioned corporate forms, there are also permanent representative offices of foreign companies (with or without authority to engage in business operations), businesses of public organizations, businesses of religious organizations.

Non-profit organizations are specially regulated, and may be shareholding companies, limited liability companies or partnerships.

In analyzing the legislation regulating business, the most suitable form of SME is the individual business and limited liability companies (SIA). This is borne out by experience, because of all types of registered companies, the most popular at present are individual businesses and limited liability companies.

Insolvency and Bankruptcy

Insolvency and bankruptcy of businesses and companies are regulated by the Law enacted September 12, 1996 "On Business and Company Insolvency" which replaced the previous law "On Business and Company Insolvency and Bankruptcy" (03.12.1991). During the four years since adoption of the first law, the number of insolvent companies in Latvia has increased rapidly, among them a number of credit institutions, and for this reason the new law relates the duties of the insolvent company itself and its administrator in more detail. The law does not apply to credit institutions and insurance companies for which, according to their special need of monitoring and supervision, norms regulating insolvency and bankruptcy were incorporated in special laws – "The Law on Credit Institutions" (05.10.1995) and "The Law on Insurance Companies and their Monitoring" (10.06.1998).

The development and assessment of regulating the process of business and company insolvency is as follows:

The law on insolvency and the resolving of it has been changed many times, and all of these changes are for the most part positive, because they are aimed at protecting creditors, administrators' freedom of action in certain cases and independence of the meeting of creditors in adopting important resolutions.

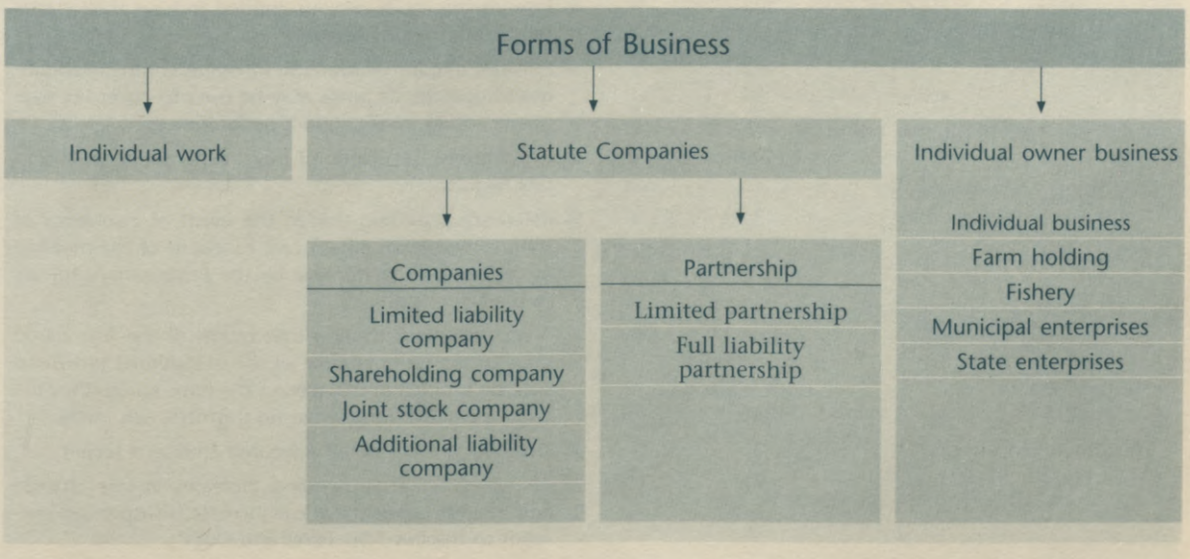

Table 18 Changes to Insolvency Legislation and Their Effect on SME

Act	Article	Effect	Remarks
The first law "On Insolvency and Bankruptcy of Enterprises and Companies" (03.12.1991)	All	+	■ Previously, this matter was not regulated by a separate law at all, but partially regulated by the Law "On Entrepreneurship".
CM Regulations No. 18 on Amendments and Supplements to the Law (issued 04.01.1994 under provisions of Article 81 of the Constitution)	2	+	■ Condition of insolvency is assumed when a debtor has defaulted on payments for more than three months;
	4	+	■ Insolvency cases are forwarded for hearing to all courts replacing the Economic court;
	5, Part 2		■ A supplement permitting institutions listed by the CM to initiate cases of insolvency of state enterprises, and municipalities of municipal enterprises.
CM Regulations No. 5 on amendments and supplements (issued 05.01.1995)	5, Part 3	+	■ A supplement permitting initiation of cases of insolvency of an insurer based on application of the National Insurance Inspectorate.
Amendments to the law (24.08.1995)	5, Part 3	+	■ Previously issued CM Regulation No. 5 becomes null and void.
New law "On Insolvency of Businesses and Companies" (12.09.1996)	All	+	■ Defines more clearly all procedural matters.
Amendments to the law (17.04.1997)	14, Part 3	+	■ A supplement providing that restrictions laid down for administrators and physical persons do not apply to their representatives;
	15	+	■ Regulations concerning the amount of administrator's bond do not apply to the Privatization Agency;
	21	+ –	■ Extends rights of administrator;
	44	+	■ Defines contents of application for insolvency;
	47	+	■ Regulation of creditors' activities due to amendments to Article 21;
	48	+	■ Corrections related to determining debtor's assets according to their book value;
	55	+	■ A supplement providing that the administrator may not reject creditors' claims regarding which a court judgement has come into effect;
	57	+	■ Amendments to the procedure for reviewing creditors' claims, due to amendments to Article 55;
	72	+	■ Administrator's rights are curtailed regarding assessment of debtor's previous activities;
	105	+	■ Sets the minimum term for announcement of tender
	107	+	■ Extends the list of persons entitled to have their claims satisfied in the first round;
	108	+	■ Provides that in the event an insolvent company continues to operate, its funds may be used to cover tax payments arising from contract performance;
	109	+	■ Reference to calculation of travel expenses according to CM Regulations;
	125	+	■ Reference providing that in the event of insolvency of state or municipal enterprises, functions of the meeting of creditors are performed by the Privatization Agency or the Municipality;
	Clause 12 of Transitional Provisions	+ –	■ A new clause, providing that claims of the first round prior to the effective date of this transitional provisions shall be satisfied in full, paying the basic amount for the entire period of time when no payment was made.
Amendments to the Law (04.12.1997)	1	+	■ Defining in more detail a secured creditor's security;
	50	– +	■ An exception in suspending increases in late charges and interest tax debts whose increase is suspended pursuant to the law "On Taxes and Dues";

Act	Article	Effect	Remarks
	Clause 13 of Transitional Provisions	– +	■ A new clause providing that debts of agricultural enterprises shall be paid in accordance of transitional with procedures set by CM and the approved list of statute companies.
Amendments to the Law (26.02.1998)	74	+ –	■ A supplement providing the scope of compensation for damages and industrial diseases of creditors employees;
	107	+ –	■ Supplements relating to amendments to Article 74;
	Clause 10 of Transitional Provisions	–	■ The deadline for special procedures concerning insolvent state and municipal enterprises of transitional is extended to December 31, 1998.
Amendments to the Law (22.10.1998)	1	– +	■ The list of authorized Government institutions is supplemented with the Insurance Monitoring Inspectorate;
	3	+	■ While specific signs of insolvency exist, the court shall consider the debtor to be insolvent;
	6	+	■ Provides that the choice of debtor's representatives to be invited to the meeting of creditors be left to the administrator;
	7	+	■ Defines choices for resolving insolvency; provides that the meeting of creditors shall also approve the debtor's annual reports;
	8	+ –	■ Amendments related to amendments to Article 6;
	13	+	■ Amendments providing for liability of a legal person;
	15	+	■ Simplifies the matter of reducing size of collateral; deletes clause on division of collateral between several administrators;
	17	+	■ Deletes the clause on appointing several administrators;
	18	+	■ Deletes the clause regulating the procedure for signing of the announcement of the administrator taking up duties;
	19	+	■ Deletes from the duties of the administrator the need to forward to the court for approval the plan of special arrangements, changes to it, resolution of the meeting of creditors concerning bankruptcy procedures, administration costs and payment schedules for repayment of debts;
	21	+ –	■ Deletes part of the clause permitting the administrator to refuse to keep a difficult-to-store property and unilaterally reject difficult contracts;
	22	–	■ Restricts the administrator's rights to obtain information from Government institutions;
	23	+	■ Deletes the part regulating administrator's liability before a court;
	24	+	■ Defines the administrator's liability;
	25	+	■ Deletes the part regulating the proportionate liability of several administrators;
	26	+	■ Defines the administrator's civil liability if such has been found by a court in a criminal case;
	27	+	■ Simplifies the procedure for expiry of the administrator's certificate;
	28	+	■ Defines that the court discharges the administrator and defines the administrator's right to appeal this decision;
	30		■ Defines forwarding the file to the administrator;
	33	+	■ Defines duties of the debtor's representative, bearing in mind that the representative is selected by the administrator;
	34	+	■ Provides that all representatives of the administrator are obligated to provide information;

Act	Article	Effect	Remarks
	38	+	■ Opportunity to submit a voluntary application for insolvency is withheld if the debtor is unable to describe his commitments (this must be done earlier);
	41	+	■ Defines the matter of evidence;
	42	+	■ Defines creditors' claims in cases when the application is submitted by the debtor;
	43	+ –	■ When submitting his application, the debtor may not immediately provide a choice of solutions to the insolvency condition;
	50	+	■ Provides that increase of late charges and interest of the debtor is suspended, and in the case of tax payments, the amount of the basic debt is not increased;
	54	+ –	■ The number of newspapers where a notice of insolvency must be published, is reduced;
	55	+	■ Provides the procedure for satisfying creditors' claims in accordance with Article 107;
	56	+ –	■ The number of newspapers where notice of a meeting of creditors must be published, is reduced;
	62	+	■ Requires the administrator to submit an application to the court to suspend insolvency process if the conditions mentioned in Law exist;
	67	+	■ Amendments protecting a third party's property in the possession of the debtor;
	68	+	■ Provides that funds obtained from sale of security at tender shall be paid to the debtor's bank account after satisfying secured creditors' claims and costs;
	69	+	■ Amendments to consider transactions invalid as at the date of effect of insolvency; also if a court decision in a criminal case finds that the debtor was forced into insolvency;
	88	+	■ Amendment waiving the need to have a scheme of arrangements approved by the court;
	90	+	■ Deletes statement that by rejecting a scheme of arrangements and settlement, the meeting of creditors has passed a resolution to declare bankruptcy;
	91	+	■ Defines scheme of arrangements and application of it;
	94	+	■ Waives the need to have extension of a deadline for a scheme of arrangements approved by the court;
	97	+	■ Amendments provide that the resolution of the meeting of creditors concerning the scheme of arrangements, changes to it, and extension of deadlines, must be registered with the Company Register;
	99	+	■ Delete the term that the court decides to suspend the scheme of arrangements;
	100	+	■ Defines at what point the meeting of creditors must pass a resolution to suspend the bankruptcy proceedings and the duties of the administrator in this regard;
	101	+	■ Deletes the term that the court decides to start bankruptcy proceedings;
	107	+	■ Deletes the term that the court approves the resolution of the meeting of creditors concerning costs of administration and the procedure for payment of debts.
Total "+"		56	
Total "–"		2	
Total "+ –" or "– +"		13	

According to the law, all businesses and companies, except credit facilities and insurance companies, are subject to the same conditions for initiating and proceeding with the insolvency process.

The court may consider a business or company (hereafter the debtor) insolvent if the following signs are found:

1) the debtor is unable to properly honour its commitments;
2) the debtor has stopped paying its debts which have become due;
3) the debtor's liabilities exceed its assets;

An insolvency case is heard following an application which may be submitted by:

1) the debtor or its liquidators;
2) a creditor or a group of creditors;
3) the administrator in an insolvency case (against another business or company which owes the debtor and is represented by this administrator);
4) authorized government institutions.

A debtor's application may be voluntary or mandatory. If a debtor is unable to honour its commitments within three weeks from their due date or its liabilities exceed its assets, the debtor is obligated to apply to the court, otherwise it may be criminally charged. This condition is not altogether realistic and should be changed because many businesses fail to honour their commitments within three weeks of their due date, especially SMEs.

The applicant for insolvency may not change the subject of the claim and withdraw an insolvency application. Cases of insolvency are heard by the Regional court at the legal address of the debtor. A receipt for having paid the state fee of Ls 100 and written evidence must accompany the application.

Announcement of insolvency. If the signs of insolvency provided by law exist, the court declares the business or company insolvent as of the day the application or claim is filed with the court, unless it is found during the hearing that insolvency was present earlier. As soon as the debtor is declared insolvent, late charges and interest on creditors' claims are stopped, as well as execution of earlier court judgements to collect.

According to the Law, creditors are divided into the following groups:

1) secured creditors – these are creditors whose claims are secured by a security (pledge);
2) unsecured creditors – these are creditors whose claims are not secured by a security (pledge).

Secured creditors may not submit an application for insolvency.

Groups of creditors have different voting rights. Secured creditors may not vote at meetings of creditors, except in cases when a scheme of arrangements is before the meeting. During the insolvency proceedings the meeting of creditors is the main decision-making institution.

The meeting of creditors is obliged to elect a creditors' committee if more than fifty creditors have registered.

In order to ensure the insolvency process, the court appoints an administrator who holds the rights and authority of the debtor's management during the insolvency proceedings. The insolvency process is terminated by the court.

The administrator may be appointed from a circle of persons laid down by law and must provide appropriate security in order to perform his/her duties – civil liability insurance or a cash bond. The administrator carries out resolutions of the meeting of creditors. He/she is obligated to comply with court decisions and demands to file reports. The administrator is fully liable for all losses caused by his/her actions and a claim may be filed with the court against him/her.

An insolvency condition may be resolved by a settlements, scheme of arrangements or bankruptcy.

Settlement, based on a project approved by the meeting of creditors, provides for an agreement between the debtor and creditor, as a result of which:

1) the amount of the claim is reduced;
2) waiving contract penalties or interest, or both, the amount of the claim and contract penalty and interest are reduced;
3) the due date of the commitment is postponed.

A settlement may be permitted at all stages of the insolvency process until the tender of the debtor's property.

Creditors may not decide on a scheme of arrangements or bankruptcy while a settlement is in effect. Applications to suspend a settlement may be made by the administrator, creditors, a group of creditors or the meeting of creditors if a breach of the law is found at the time of agreeing to the settlement.

The aim of a scheme of arrangements is to prevent the debtor's possible bankruptcy and re-instate its solvency, as well as satisfy creditors' claims. A scheme of arrangements is approved by the meeting of creditors and it is registered with the Company Register of RL. The process of a scheme of arrangements, which may

not exceed two years, is managed by the administrator.

Bankruptcy is a solution to the insolvency condition demonstrated by liquidation of the debtor and satisfaction of creditors' claims as fully as possible from funds obtained during the liquidation process by selling the debtor's property. The decision to begin bankruptcy proceedings is made by vote at the meeting of creditors. The debtor's property is sold at open auction organized by the administrator.

Funds for the insolvency process are obtained by collecting outstanding debts owing to the debtor and selling assets held by the debtor. The funds so obtained are used to pay administration costs, duly approved by the meeting of creditors. Creditors' claims are paid in two rounds. The first (priority) round includes the following groups:

1) employees' wage claims for three months; claims for holiday pay and social benefits for one year; compensation for injuries at work and tax payments for unlimited time; payment of social tax entitling to unemployment benefits;
2) payment for agricultural production delivered to processing plants;
3) claims for payment of social tax for one year;
4) government claims for repayment of government guaranteed loans;
5) claims for payment of other taxes and dues;

The second round includes the following groups:

1) claims of other creditors (basic amounts of debts only, without interest), including remaining wages and other payments under valid labour relations, postponed tax payments;
2) claims for interest payment to both priority and other creditors;
3) claims of creditors who have filed their claims after the deadline.

Commitments to the second group of creditors are satisfied only after claims of the first group of creditors are satisfied in full. In the event the funds of the debtor are insufficient to satisfy claims of all creditors, payments are made proportionately to one group.

Once a business (company) is declared bankrupt by court order, the Minister of Finance, pursuant to a recommendation of the Tax Administration, cancels government taxes and dues owing and penalties, amounts increasing the main debt and late charges.

Conclusions

1. The new Law "On Insolvency of Businesses and Companies", compared to the previous one, defines the condition of insolvency, rights and obligations of participants in the insolvency process, finalizing the process and sequence for satisfying creditors in more detail and more clearly. However, the process is cumbersome, its performance is complicated and it does not sufficiently protect interests of creditors – physical persons.
2. On a positive note, matters of insolvency of credit facilities and insurance companies are set out in special laws because these companies form a higher risk group and their operations are individually regulated.

The Tax System

A General Description of the Tax System

The proportion of taxes in the GDP of Latvia cannot be considered especially high (36–37%). Latvia has one of the lowest income tax in Europe – 25% – and this rate is constant compared to the beginning of the nineties, when a rising scale of 15–45% was introduced. Dividends are not taxed, except dividends paid to non-residents, in which case a tax of 10% is levied. Residents' income tax is the same as corporate tax (25%), in this case there is a tax-free amount, but it is symbolic – Ls 21 a month. It must also be noted that Latvia has a high VAT (18%). Until 1993 the VAT rate was 12%. Although the rate was increased practically at the same time as the income tax rate was reduced, thus applying the principle "tax the consumption rather than profit", it must be remembered that it is the increased VAT that slows down business of any kind rather than income tax. Furthermore, VAT in Latvia is higher than in the main capital exporting countries (USA, Germany, Japan).

Furthermore, Latvian business people must take into account very high social insurance payments – 37% of earnings. 28% of this amount is paid by the employer, and 9% by the employee. It is intended that by January 1, 2001 the payment will be reduced to 33%, paid in equal parts by employer and employ-

ee. The amount of social insurance payments exceeds the average amount in Europe and can be considered a serious obstacle to business development. Besides, it must be noted that taxes levied on real property (up to the end of 1999 – 1.5% of the cadastral value of land per year, but beginning with the year 2000, 1% of the total assessment value of land and buildings), cannot be considered high on the surface, however, considering the undeveloped real property market and low market value of properties, even these rates slow down investment in real property. On a positive note, property tax on assets was revoked in the Spring of 1998 (effective January 1, 1991), which could amount to 4% of the value of assets per year and was a serious obstacle to any development of manufacture.

It should be further noted that, in order to stimulate business, the law provides for a 20% tax reduction for SMEs, thus reducing the tax rate from 25% to 20%. It should be noted, however, that business criteria laid down in Latvia (that the number of employees not to exceed 25, that the value of assets should not exceed Ls 70,000, net turnover – Ls 200,000) are considerably stricter than those in the rest of Europe. At present most small businesses in Latvia work either without any profit or a very small profit, thus the tax relief has little meaning. Altogether, corporate income tax makes up only 8% of the total tax revenue. This shows also the trend of businesses (especially SMEs) to avoid direct tax payments and the inability of tax administration institutions to prevent this trend. Thus activities which must be carried out in the area of tax policy in relation to promotion of business, must be targeted in two directions: 1) improve tax administration by making certain amendments to legislation, motivating businesses to maintain better bookkeeping, show real wages and salaries and pay taxes, urging employees to monitor employer payment of social tax for them, consider opportunities to reduce social insurance payments or reduce the types of income on which social tax is paid; 2) reduce or compensate rates of individual taxes on income invested in the company's long term development, also in order to promote the introduction of more environmentally friendly technologies and create new jobs.

In order to ensure the country's development and performance of its functional duties, considerable funds are needed. Consideration of these costs determine the country's income policy, as a result of which mandatory payments to the government are set. Taxes and dues are the levers ensuring that a country functions. Payment of taxes is regulated by law, and these payments are mandatory and must be paid without question. Dues may be charged on services provided by the government and municipalities.

The tax and dues (fees) system in Latvia is made up of:

1) Government taxes, whose rates and objects on which taxes are levied, are determined by the Saeima;
2) Government dues (fees) levied in accordance with the law "On Taxes and Dues", as well as other laws and CM regulations;
3) Municipal dues (fees) levied in accordance with the law "On Taxes and Dues" and regulations issued by the Council of municipalities.

The government has set the following taxes by law:

1) residents' income tax;
2) corporate income tax;
3) real property tax (property tax, land tax);
4) VAT;
5) excise tax;
6) customs tax;
7) natural resources tax;
8) lotteries and gambling tax;
9) social tax.

The Law of the RL "On Taxes and Dues" was passed by the Saeima on February 2, 1995 and came into effect on April 1, 1995. Until then a similar law "On Taxes and Dues in the Republic of Latvia" was in effect.

Development of these laws is as follows in Table 19.

The new law revolutionized the Latvian tax and dues system. From the standpoint of the government tax administration, it was a step towards order in the tax system itself. From the standpoint of technicalities and quality, it was a law of a new quality. The number of articles doubled, their parts were defined and legally better formulated. Regarding the content, the law:

- cancels the profit tax and replaces it with corporate tax;
- sets a new-real property – tax which will replace land tax and property tax;
- cancels road tax;
- cancels turnover tax, replacing it with VAT;
- customs tax retains its place in the system;
- the Law provides dues and authority in levying same;

Table 19 Changes in Tax Regulations and Their Effect on SME Operations

No.	Date adopted	Description of normative act	Norms affected	Effect	Remarks
1	28.12.1990	New law	All	+	■ RL own basis for tax system.
2	09.04.1991	Amendments to law	Article 6	+	■ On providing effective date of amendments and new laws in the laws themselves.
3	23.12.1991	Supplement to law	Article 6, Part 2	–	■ A new part providing for the need to have expertise performed by the ME prior to reviewing amendments to legislative acts on tax dues.
			Article 6, Part 3	+	■ A new part requiring the MF to index tax and dues rates set in absolute amounts once every three months.
4	17.06.1992	Amendments and supplements to the Law	Article 3	+	■ Supplements with reference to international agreements;
			Article 3 Part 2	+	■ A new part referring to the Vienna Convention of diplomatic and consular contacts in applying taxes and dues to members of foreign diplomatic corps;
			Article 7–1	+	■ A new article providing that a person authorized by the Council of Ministers may sign interstate tax conventions;
			Article 11	–	■ Requires that instructions for procedures and reporting for calculation of taxes and dues as well as completion of tax declarations are prepared by the National Finance Inspectorate;
			Article 12, Clause 1	+	■ Defining inclusion in taxpayers' roll;
			Article 17, Parts 3 and 4	+ –	■ Change of wording in places, emphasizing reduction rather than avoidance of taxes; deletes Parts 3 and 4;
			Article 18	–	■ Amends wording of this article, providing that calculations of penalties shall be paid to the budget within ten days after the decision of the National Finance Inspectorate or municipality is adopted;
			Article 19	+ –	■ Replaces the word "demand" with "decision";
			Article 24	+	■ Amends wording of the article, providing that disputes are heard as provided by RL law or interstate agreements and that the latter have priority over RL laws.
5	09.02.1993	Supplement to the Law	Article 15, Part 1	+	■ On re-imbursement of overpayment of taxes and dues.
6	18.05.1993	Amendments to the Law	Article 5	+	■ The need for Government approval prior to review of a draft law on amendments and setting of the effective date for new laws in the laws themselves; on non-interference with the work of the National Finance Inspectorate;
		Amendments	Article 6	+	
		Supplements	Article 10, Parts 2, 3, 4	–	
		Amendments	Article 11	+	■ On duties and authority of the Finance Inspectorate;
		Supplements	Article 12 Clauses 3, 4, 5	+	■ Extends the rights of taxpayers;
		Amendments	Article 13 Clause 3	–	■ Increases the amount of late charges;
		Amendments	Article 15	–	■ Tax indexation;

No.	Date adopted	Description of normative act	Norms affected	Effect	Remarks
		Supplements	Article 16	–	■ On increase of penalties and authority of Finance Inspectorate;
		Amendments	Article 17	–	
		Supplement	Article 19, Part 2	+	■ Waives penalty.
7	09.06.1993	Resolution of Presidium of SC	Article 3 Part 2	+	■ Renews re-payment of turnover tax to diplomats.
8	15.06.1994	Amendments	Article 2	+	■ Cancels special extra-budget fund;
		to the Law	Article 5	+	■ Defines authorization of legislator and municipalities;
			Article 8, Clause 4	–	■ Restriction of cash;
					■ Defines more precisely the object on which tax is levied;
			Article 9, Part 1	–	■ On payment to special budgets;
			Article 12, Clause 4	–	■ On declaring transactions in excess of Ls 3,000;
			Article 15	–	■ Sets the rate for debt refinancing by BL;
					■ Sets the maximum late charges which may not exceed the main debt, as well as the possible extension of the due date for debts and reduction of late charges;
			Article 17, Part 6	–	■ Increases penalty;
			Articles to which transitional provisions apply	–	■ The Finance Inspectorate is replaced by the National Revenue Service;
					■ Increases authority of CM.
9	01.04.1995	New Law	All	+	■ A new system, procedures, and a more extensive scope of rights of the taxpayer.
10	06.06.1996	Amendments	Article 1	+	■ Defines wording;
		Supplements	Article 2	+	■ May not apply payments set by CM without amendments to this Law;
		Amendments	Article 6	+	■ Defines authority of tax administration;
			Articles 11, 12, 13, 15, 20	+	■ Regulates payment of taxes and dues;
			Article 24	+	■ Extension of date for payment and capitalization;
			Article 25	+ –	■ Conditions precedent for repaying debts; extends the scope;
			Article 28	+	■ Defines repayment procedures;
			Article 29	+	■ On provisions at what point the increase of main debt is stopped;
			Article 30	–	■ Sets stricter provisions for declaration of cash;
			Article 32	–	■ Liability of the taxpayer is increased;
			Article 34, Clause 1	–	■ Rights of NRS to suspend operations;
		Amendments	Article 41	+	■ On agreement with tax administration.
Total "+"				27	
Total "–"				18	
Total "+ –" or "– +"				3	

- introduces new sections – on taxpayers, on tax administration, on calculation, payment, repayment and write-offs of taxes, on appeal of resolutions of tax administration.

The new law "On Taxes and Dues", which can rightfully be called the blanket law of the tax and dues system, is supplemented by many CM regulations, as the law itself provides. For the most part these are regulations on various dues, their amounts, on tax holidays, write-offs, capitalization, etc. In addition, the National Revenue Service provides its instructions and directives in the form of announcements or letters: on application of specific articles, on checking payments, on payment schedules, on making payments, on State fees etc., which for the most part are not published and yet are applied. Only in specific cases are these documents signed by the Head of the NRS, usually they are signed by his various deputies, department directors or their deputies.

Considering the importance of tax administration to the national economy, it would be advisable to stop various office managers from providing general instructions, notices and directives; in such cases the publication should be signed by only one designated government official.

Government fees are levied according to the law and CM regulations. Only the following fees are levied by law:

1) port and shipping fees,
2) annual motor vehicle fees,
3) lotteries and gambling fees,
4) fees for court services,
5) fees for changing entry of surname, name and nationality in documents of identification,
6) fees for reserving land in rural areas,
7) fees for certification and other services in Orphans' and District courts, and
8) airport fees.

The following fees are payable for government legal and other services:

1) registration of public organizations and their associations,
2) for notarial services,
3) registration, changing and supplementing vital statistics,
4) registration of publishing and the media,
5) company registration,
6) receiving information from the RL Company Register,
7) receiving information from the Residents Register,
8) issue of emigration documents,
9) issue of special permits (licences) for specific types of business operations,
10) transactions involving Promissory Notes,
11) transactions involving certificates,
12) issuing residence permits and services related thereto,
13) issuing visas to enter RL and services related thereto,
14) passports and other documents of identification or rights,
15) registration of residents at their domicile,
16) protection of rights of selectioners,
17) protection of industrial property (inventions, trade names, samples of designs and other industrial property),
18) submitting application to naturalize, and
19) services of Customs Offices.

Town and parish (*pagasts*) Councils may levy municipal dues (fees) within their administrative territory on the following:

- official documents and certified copies issued by the Municipal Council,
- organizing public events of entertainment and relaxation,
- tourist accommodation,
- retail trade in public places,
- keeping any kind of animal,
- entry by motor vehicle in specially indicated areas,
- placing posters and advertising in public places,
- the keeping of boats, motor boats and yachts, and
- the use of municipal attributes.

Government dues (fees) are paid to the national budget, but government dues (fees) received by municipalities and municipal dues are paid to the budget of the relevant municipality.

As is evidenced by the list of dues above, practically every business or company faces paying a number of types of dues or fees, either when registering the company, or obtaining the appropriate licence or preparing and receiving various documents. All this only increases the company's burden of costs even before start of operations, because government dues are not symbolic: they represent a significant amount, especially for the individual or small business. The main obstacle is uncertainty regarding deadlines and procedures, a fact which, coupled with the dues or fees, increases indirect costs.

Conclusions

The Latvian tax system is an important part of the national revenues, and it is laid down and regulated by a blanket law on taxes and dues. Revisions to this law can be assessed mainly positively, through the effects have had little impact on SMEs, although indirectly important basis was laid for future government and SME co-operation on tax issues.

In the early nineties, a stabilization of revenues could be observed when the government, by revising the law, gradually became stricter towards businesses in matters of tax payments, increasing amounts of penalties, and granting greater authority to finance inspectorates. This had a negative effect on SMEs. However, it must be remembered that the first blanket law in the tax area was very general and SMEs had every opportunity to develop their operations.

Adoption of the new blanket law in the latter part of the nineties meant that the tax system was already working and a few improvements changed the new law. Many of these improvements concerning SMEs were positive – more opportunities to extend deadlines for tax payments, capitalization, suspension of calculation of main debt increase, opportunity to come to an agreement with the tax administration. All this lets us conclude that legislation of the tax system and revisions made to it were loyal to the SMEs and established a basis for establishing SMEs and their stability in future operations.

Rights and Obligations of Taxpayers

Before starting operations, business people, businesses and companies – all legal and physical persons – must register with the local tax administration – the National Revenue Service, the State Social Insurance institution and other government institutions, if required by law. The local tax administration is situated in the region, town or municipality of the company's or business's legal address, but in the case of physical persons, their registered or permanent residence address.

The obligations of taxpayers provided in normative acts is much broader than the rights granted to them, evincing that the matter is strictly regulated in detail. In addition to registration, obligations of taxpayers include: calculation of taxes, full and timely payment of them, declaration of income, documentation of accounting and transactions, keeping and producing these documents on demand, reporting any changes, reporting, etc. In fact, the taxpayer must do everything to reflect precisely his business operations in accordance with requirements of normative acts and all payments to the government and municipality are made in full. Taxpayers are entitled to take advantage of tax and dues relief and holidays as provided by law, and examine free of charge normative documents regulating calculation and payment of dues and taxes. Taxpayers may examine documents checking calculations of taxes and dues, defend their interests by appealing decisions of tax administration to a higher instance, except decisions charging administrative penalties, to a higher court.

Table 20 The Proportion of All Taxes in Government and Municipal Revenues

No.	Type of income	% 1995	% 1996	% 1997	% 1998
1	Social tax, social insurance payments	37.35	28.21	28.88	32.76
2	Value Added Tax	28.41	30.60	26.68	24.25
3	Residents' income tax	17.20	17.50	16.96	16.83
4	Excise tax	4.56	10.03	11.09	12.99
5	Corporate income tax	6.14	6.55	7.27	7.08
6	Customs tax	2.36	2.13	2.03	1.51
7	Property tax	1.93	2.09	1.87	2.10
8	Land tax	1.40	1.47	1.57	0.22
9	Real property tax	–	–	–	1.39
10	Natural resources tax	0.19	0.20	0.85	0.82
11	Other tax revenue	0.46	1.22	2.80	0.05
12	Total	100	100	100	100
13	Amounts in thousand Ls	774,262	874,623	1,081,589	1,304,669

Source: Latvian Statistics Yearbook 1999.

Taxpayers are entitled to receive compensation for loss and damages including those caused by failure to transfer funds if such loss and damages are caused through the actions or mistakes of the tax administration. The law protects the rights of taxpayers to confidentiality of information. However, the rights of taxpayers are very limited. There exists the right to apply relief from taxes and dues and tax holidays, but not everyone is able to take advantage of these, and therefore at present these are very minimally applied. It is also possible to have overpayments returned; however, as a result, relations with the tax administration may deteriorate and special monitoring may be enforced. Furthermore, the time involved in returning overpayments is long, and the government uses this money but pays no interest except in cases when the tax administration has wrongfully collected payment and the taxpayer has to pay additional rate of refinancing as provided by law, the amount of which is set by the Bank of Latvia. The right to receive information and statements does not affect the interests of taxpayers, because they already know when and what has been paid, but it is in the interests of other government institutions, especially Customs, a structural unit of the National Revenue Service.

Under normal conditions a taxpayer should, prior to starting business operations, register his operations once, with the Company Register of RL, because registration with the tax administration is the same action, duplicated. When registering, business information could be forwarded automatically to the tax administration, which would then receive notice of any changes in the same way.

The Company Register, the National Revenue Service and other government institutions should be linked by a single information network, thus avoiding the need for a business to repeatedly submit one and the same information, and could thus carry on their operations with better economic efficiency. This network should include information available to the public, like the internet, as well as information used only by the civil service. There must also be opportunity for the public to obtain information on their operations, and forward explanations and reports to the tax administration by e-mail. In this way taxpayers would be able to follow up whether the information they have submitted is properly used and request that it be corrected in time if necessary. If such information were widely accessible, it would facilitate work for both sides and save time and money for the business.

Conclusions

Remembering that for the businesses the burden of taxes and red tape is heavy, both the tax administration and the businesses are interested in simplifying their relations and avoiding frequent visits to the National Revenue Service by business people. To this end, it is necessary:

1) when establishing any kind of a business or company, register only once, avoiding duplicated registration with the National Revenue Service;
2) that any information needed by a government institution that is available at another government institution, and should be first requested from that institution or the data network;
3) urgently introduce an electronic system for signature and document approval, which would allow official documents such as reports to be forwarded directly from the computer of a company's accountant or manager;
4) to reduce the number of reports which must be regularly provided to the statistics service, a part of which is duplicate of information provided to the National Revenue Service (each month every company spends 10 man-hours or more to complete forms. These hours of non-work are also lost to the government). The same may be said regarding the annual report – it is unnecessary to submit it repeatedly to different institutions when this matter could be arranged between the NRS and the CR;
5) that the NRS should make use of individual information and warning procedures in the case of new normative acts affecting business more often, amendments to existing acts, and failure to comply with certain obligations, since business provides most of the national revenue in the form of taxes and such an understanding would be of mutual benefit.

Residents' Income Tax

Application of residents' income tax is important to owners of individual businesses (family business, farm holdings, fisheries) whose operations are relatively small. These businesses which, pursuant to the law "On Corporate Annual Reports" do not submit annual reports, do not pay corporate income tax, but pay tax on their income pursuant to the law "On Residents' Income Tax". Let us examine this law more closely.

Residents' income tax is a tax levied on the income of physical persons. It is paid by:

- residents who are domestic taxpayers, on income received in the Republic of Latvia and other countries;
- non-residents who are foreign taxpayers, on income received in the Republic of Latvia;
- owners of individual businesses on income on which corporate income tax is not levied.

Residents' income tax is levied on wages and salaries, income from individual work and business contract, from an individual business, from a partnership, from renting out or leasing real property, from sale of an item and from renting movable property (chattels), from intellectual property, from gifts received from companies, pensions, regardless of their source, and other income, except:

- income from personal agricultural production up to Ls 3,000 a year;
- dividends, income from investments and deposits with credit institutions;
- insurance compensation except in specific cases;
- winnings from lotteries and other games of chance not in excess of Ls 500;
- income from government and municipal bonds;
- benefits, scholarships, alimony, compensation, subsidies and other income which, similarly to the above, are defined and listed in Article 9 of the law "On Residents' Income Tax".

At present, a law is in force which was adopted on May 11, 1993, but the original wording of the law regulating residents' income tax was passed on December 12, 1990. The law is regularly revised and supplemented, which at certain times aggravates the situation between the taxpayers and the administration. Development of the law "On Residents' Income Tax is shown in Table 21.

Residents' income tax is regulated not only by the legislator but also by CM Regulations. Table 21 shows the instructions for application of this law which is much broader than the law. To supplement the law, the CM has issued the following regulations:

- on the procedure for issuing Wages Tax Book and card;
- on permitted expenses in relation to educational and medical services; it should be noted here that expenses concerning higher and professional education should be differentiated because costs of higher education amount to hundreds of lats, or the full costs of education should be considered permitted expenses, which would stimulate any person to attain professional qualifications.
- on the expenses of athletes of the Latvian Olympic Team;
- on regulations for applying provisions of the law;
- on the procedure for re-imbursing expenses related to business trips;
- on functions of the tax administration;
- on the annual declaration;
- on the territorial distribution of tax revenue;
- on additional relief for the disabled, politically repressed persons and members of the national resistance movement;
- on the procedure for levying tax on income gained from selling lumber and forests;
- on the procedure for levying tax on income gained from lotteries and games of chance;

Table 21 Changes to the Law "On Residents' Income Tax" and Their Effect on SME Operations

No.	Date Adopted	Description of Normative Act	Norms affected by the Act	Assessment	Notes
1	12.12.1990	Original law	All	+	■ Earlier, norms set by the Latvian SSR were in force.
2	05.03.1991	Amendments	Article 8	+	■ Laid down first tax free amount in Rubles; ■ Reduces taxes levied on large income;
			Article 9	–	■ Reduces relief for the disabled of Group 3;
			Article 21	+	■ Amending wording to clarify text.
3	30.04.1991	Amendments	Article 9	+	■ Increased relief for the disabled of Groups 2 and 3 and other persons;
			Article 21	+	■ Increases the tax free amount for persons performing creative work.

No.	Date Adopted	Description of Normative Act	Norms affected by the Act	Assess-ment	Notes
4	30.04.1997	Resolution of Supreme Council	Article 9, Clause 21	–	■ The law comes into force retroactively.
5	07.08.1991	Amendments	Article 4	+	■ Increases the number of types of income on which tax is not levied;
			Article 21	–	■ Tax is levied on minimum income gained from royalties;
			Article 37	+	■ Amending wording to clarify text.
6	17.09.1991	Amendments	Article 9	+	■ Increases tax free amount for the disabled and other persons;
			Article 21	+	■ The same – for persons who are not permanently full-time employed.
7	17.09.1991	Resolution of Supreme Council	Article 9.21	–	■ See Clause 4.
8	2611.1991	Amendments	Article 9.21	+	■ See Clause 6.
9	15.01.1992	Amendments	Article 9.21	+	■ See Clause 6.
10	15.01.1992	Resolution of Supreme Council	Article 9.21	–	■ See Clause 4.
11	25.02.1992	Amendments	Article 3, Part 2	–	■ Tax on income in foreign currency must be paid in that currency at a higher rate;
			Article 4, Clauses 17, 19, 20,	+	■ Amounts replaced by minimum monthly salaries;
			Articles 18, 19, 21	+	■ The same;
			Article 8	+	■ The same;
			Article 9	–	■ Reduces the tax free amount for the disabled;
			Article 14	+	■ Increases the tax free amount on income gained from second employment;
			Article 15, Parts 4, 5, 6	+	■ Deleted;
			Article 24, Clause 3	+	■ Amended wording to clarify text.
12	25.02.1992	Resolution of Supreme Council	Articles 9 and 21	– +	■ See Clause 4;
				–	■ Changes to tables because minimum wage is increased.
13	11.05.1993	New Law	All	+	■ More precisely formulated;
				–	■ More complicated to apply;
				–	■ Revokes the progressive rate;
				–	■ Reduces the number of types of income on which tax is levied.
14	09.12.1993	MF Instruction	Al I	+	■ Explains and regulates application of provisions of the law;
				–	■ Complicated to apply.
15	14.01.1994	Amendments	Article 13, Clause 1	+	■ Broadens the circle of dependants;
			Article 26	–	■ Restricts municipalities;
			Articles 36, 38	+	■ Defines authority.
16	27.10.1994	Amendments	Article 9, Clauses 10, 22	+	■ Increases the number of types of income on which tax is not levied.
17	19.01.1995	FM Instruction	Appendix 7	–	■ Supplements instructions.
18	01.03.1995	Amendments	Article 19	+	■ Permits extension of deadline for tax payments.
19	31.05.1995	Amendments	Almost all Articles	+	■ Increased relief;
				–	■ Increased the limit at which additional rates are calculated to Ls 600,000.

No.	Date Adopted	Description of Normative Act	Norms affected by the Act	Assess-ment	Notes
20	29.02.1996	Amendments	Article 9, Part 22	+	■ Increased relief;
			Article 17, Parts 17, 18	–	■ Estimated withholdings.
21	19.12.1996	Amendments	Article 3, Clause 9 of Part 3	+	■ Renewed not levying tax on income gained from personal agricultural production;
		Supplements	Article 8, Clause 10 of Part 3	–	■ Taxing pensions;
		Amendments	Article 9, Clauses 5–6	–	■ Taxing winnings;
		Supplements	Article 10, Clause 5 of Part 1	–	■ Increases section on permitted expenses;
			Article 11, Parts 1–3	+	■ Increases section on income;
			Article 11, Part 7	–	■ Presuming and deducting amounts of expenses;
			Article 12, Part 3	–	■ Defines application of the tax free minimum;
			Article 13, Part 1	+	■ Taxing pensions;
		Amendments	Article 15, Part 3	–	■ Revokes the high limit at which additional rates are applied; revokes additional rate;
			Article 17, Part 10	+	■ Increases types of income from which tax is withheld at source;
			Article 18, Part 4	–	■ Not including patent payment in tax advance payment;
			Article 19	–	■ Complicates calculation of taxes;
			Article 20	–	■ On non-declaration of income;
			Article 22	–	■ extending rights of tax administration;
		Amendments	Article 24	+	■ on application of interstate agreements;
			Article 26	–	■ Restricting rights of municipalities;
			Article 29	+	■ Increases obligations of employers;
		Amendments and supplements	Articles 31, 31.1, 2, 32, 32.1	–	■ Increases liability of employers and payers;
		Amendments	Article 33	–	■ Collection of taxes on a no contest basis;
		Supplements	Transitional Provisions	–	■ The law is back-dated, presuming amounts of expenses based on income from sales.
22	02.10.1997	Amendments	Article 11, Parts 7, 8	+	■ Revokes estimated of expense amounts and withholding of taxes when paying for lumber and standing forests.
			Article 17, Part 10 and transitional provisions	–	■ Determining of procedure for levying tax on this income is entrusted to the CM.
Total "+"				32	
Total "–"				33	
Total "+ –" or "– +"				0	

■ on the monthly tax-free amount when calculating residents' income tax;

The monthly tax-free amount in these regulations has always caused dissatisfaction and disagreements; therefore, let us look at recent revisions.

Already in 1994, when the regulations on the minimum tax free amount were adopted, the government levied residents' tax on the tax-free amount. In 1997 the tax administration continued this practice, addressing tax revenue problems at the cost of residents' income tax. When determining the tax free minimum, the minimum wage, as in 1994, and the residents' minimum consumption basket (subsistence minimum) should be considered.

The legislation and CM normative acts are supplemented by NRS directives, notices, letters and documents of individual municipalities and Ministries:

■ on withholding and paying earnings (!) tax (10.01.1994 letter from MF State Secretary and

Director of the Department of Tax Control; not published);

- on relief for dependants (28.01.1994 notice from Deputy (!) Director of the NRS Tax Control Department, not published);
- on taxing income of the unemployed, gained from taking part in paid temporary public work (09.03.1994 notice from Deputy (!) Director of the NRS Tax Control Department, not published);
- on registration of payers of residents' income tax (04.08.1995 notice from Deputy (!) Director of the NRS Tax Control Department, not published);
- on specific matters in calculating residents' income tax (05.09.1995 notice from Deputy (!) Director of the NRS Tax Control Department, not published);
- on procedure for paying residents' income tax (04.01.1996 notice from Deputy (!) Director of the NRS Tax Control Department, not published);
- instructions issued by the Minister of Finance on 01.02.1996 concerning the tax free amount;
- on procedure for foreign nationals to pay residents' income tax (21.03.1996 notice from Deputy (!) Director of the NRS Tax Control Department, not published);
- Orders of City of Riga Municipality (Dome) on submitting tax payment reports;

Orders from the Ministry of Transport on 14.08.1996 to list professions (trades) related to excursions and moves;

- on taxing income gained from lease of property and premises (27.05.1996 notice from the NRS Tax Control Department, not published);
- order issued by Minister of Finance on 25.10.1996 on corrections to corrections on residents' income tax revenue in municipal budgets;
- on substantiating documents in calculating taxes (11.11.1996 notice from Deputy (!) Director of the NRS Tax Control Department, not published);
- on application of relief and tax free minimum when calculating taxes (01.10.1997 notice from Deputy (!) Director of the NRS Tax Control Department, not published);

These documents are not the only ones which are applied in addition to the law. Special attention is drawn to the fact that these documents are prepared and issued by various ranks of civil servants and that most of these documents are not published. Although some of these documents were addressed to NRS structural units, they are of importance for employers and employees and owners of individual businesses and performers of individual work, because civil servants apply the law, guided by these letters to the taxpayer who is often not aware of these instructions.

Conclusions

Residents' income tax is not only one of the most important sources of revenue for the national and municipal budgets, it is also one of the most important taxes that must be taken into account by a business when entering into employment relations. It is the responsibility of the employer to calculate and pay into the budget his employees' income tax amounts. Frequently employees' wages and salaries are deliberately shown and entered on the books according to the minimum calculations, but much larger amounts are in fact paid. Such actions have a negative effect on the national revenue. Not all employers tolerate such actions. However, until the government's policy in matters of the tax free amount, introduction of a minimum and differentiated tax rate, and increased relief is significantly changed, a large number of employers, especially SMEs, will be forced to save their money and develop their business operations by various means of tax evasion.

Table 22 Changes in the Tax-Free Minimum During the Period 1994–1996

Date adopted	Effective Date	Rate in Ls	Article	Notes
19.04.1994	01.05.1994	22.50	12	Relates to the minimum on which tax is not levied during the year
		15.00	9, 13, 15, 17, 20	Relates to various relief.
12.03.1996	01.07.1996	25.00	All	A positive solution over two years.
24.12.1996	01.01.1997	21.00	All	Regulations which returned business people to 1993 conditions.

Social Tax (Social Insurance Payments)

On October 21, 1997 the RL Saeima adopted a new Law "On State Social Insurance", effective January 1, 1998, replacing the law "On Social Tax". However, let us look at the old law, too, in order to gain a complete idea how this tax developed in the RL.

The social tax is not only of great importance in addressing issues of the country's social economy, but also in affecting every member of the population, because this tax is linked to pension and social benefit payments. The old law is not forgotten, because in analyzing activities of legal and physical persons during the specific time period, the legislation in effect at the time is taken into account. Therefore, we shall look at both laws related to social insurance, both the old and the new.

The social tax is a mandatory payment to the national special social insurance budget, which ensures the rights of socially insured persons to old age, disabled or loss of the family bread – winner pensions, as well as sickness, maternity, funeral benefits and payments in case of unemployment.

Social tax is paid by the employers, employees and the self-employed. Employers pay only in cases when, pursuant to the law "On Taxes and Dues", they are considered residents. Employees also pay only if they are residents, and payments are mandatory regardless whether they are employed by a resident or non-resident.

The tax is levied on the income of all socially insured persons, regardless of the way this income is received, except:

1) pension and payments from pension funds;
2) benefits provided in normative acts;
3) remuneration to trustees and maintenance money to children/wards;
4) payments of compensation within certain amounts except compensation for annual vacation not taken;
5) benefits provided in the Labour Code, paid in the event a person is discharged;
6) compensation for injuries if someone is disabled;
7) scholarships of students attending educational facilities listed in national normative acts;
8) royalties;
9) government and municipal assistance in cases of natural disasters or other emergency conditions;
10) donor's assistance;
11) funeral benefit paid by employer, not exceeding Ls 100;
12) income in excess of Ls 1,000.

Until December 31, 1996 the basic rate of social tax was 38%, but starting January 1, 1997 the basic rate is 37%, divided in two: 28% is paid by the employer, and 9% by the employee. This is a new procedure and was introduced at the time the law "On Social Tax" was adopted on November 23, 1995 whose transitional provisions provided the following procedures:

Article 5 of the law provides that the basic rate of the social tax is 33% which the employer and the employee pay in equal shares. The table shows that according to the transitional provisions, starting with the year 2001 the rate will be 33%, but the distribution is not equal. On February 8, 1996 the Saeima passed amendments which provided that payment in equal shares must start on January 1, 2001, but later this was changed by normative acts.

At the core of the law, a radical distribution of the tax rate between the employer and employee, as a result of which the amounts of payments would be practically equalled. Neither employers nor employees are ready for these changes. Employee income is not increasing at a rapid rate, and thus, their income is in fact reduced. Employers, wishing to keep their employees, are forced to increase their employees' gross income, in order that their actual "take-home" pay would remain the same. However, not all employers, and especially SMEs, are financially able to increase the gross earnings of their employees, because along with the increase of the social payment, the income tax of the employee also increases. The result is the same – employers use the minimum amounts on their books in order not to have a conflict with the minimum wage set by the government, but actual payments to employees are made to equal the level accepted in the labour market.

In addition to the basic rate, when amending the law, a reduced rate was introduced for one year – until January, 1997, for persons employed in agriculture.

Persons who, according to normative acts, are entitled to a work pension when determining their insurance history, pay a higher social tax rate. For persons who receive the work pension with an insurance history of up to 20 years, the rate is 51%, but for persons who receive the work pension with an insurance history of up to 25 years, it is 43%. In this case, too, a gradual distribution of the rate between employer and employee is intended, but no change is provided in the amounts.

Table 23 Changes in Social Tax Rates

Effective Date	Employer's rate	Employee's rate	Total rate
01.01.1996	37%	1%	38%
01.07.1996	33%	5%	38%
01.01.1997	28%	9%	37%
01.01.1998	25%	11%	36%
01.01.1999	23%	12%	35%
01.01.2000	20%	14%	34%
01.01.2001	18%	15%	33%
01.01.2002	16.5%	16.5%	33%

The legislator, considering the need to protect the socially vulnerable groups of society and difficulties of the government to reach a balanced budget, carried out changes in legislation of social tax. Altogether, over seven years, it looks like in the Table 25.

According to the new law "On State Social Insurance", the present social insurance payment rates – 37% (28%–29%) – are retained. This means that all this time stability in payment calculations will be retained, but afterwards a drastic division of payment will take place, to make the proportion between employer and employee equal (16.5% + 16.5%). Whether this will happen cannot be stated for certain because the previous changes to the legislation show that a drastic division of tax payments causes dissatisfaction on the part of both payers. Luckily, there is still time before January 1, 2002 to consider the issue carefully.

What changes have taken place? The first that must be mentioned is the decision to transfer the administration of social insurance payments to the NRS as of January 1, 1998. Structural changes took place at the social insurance fund because it was changed into a state-run joint-stock company, whose main function is to ensure social assistance functions, and not collecting money.

The law has provided strictly that all those employed who have reached the age of fifteen years are subject to social insurance. In a way, it is an age census. Since the law does not provide for what to do if younger persons are employed, no tax is payable. This condition can be successfully taken advantage of by businesses which do not require qualified labour, for example agriculture, gardening and others. However, when taking advantage of this condition, Chapter 12 of the Labour Code must be observed, which regulates employment of youths.

A significant new fact is that the law defines social insurance payment objects. The previous law provided that social tax is not paid on all income subject to income tax. This caused problems for bookkeeping, but at the same time permitted an optimization of tax payments of sorts. The new law provides that social insurance is to be paid on all income on which the employee pays residents' income tax, without deducting the tax free amount, tax relief and expenses by which a taxpayer is entitled to reduce taxable income, as well as payments to licensed pension funds (Article 14).

The new law has a broader definition of an employer. It defines more precisely a self-employed person. This person will now have to pay social tax, the amount of which will be determined by the CM. Self employed persons had to pay a social tax before, payed on the minimum wage, but in 1996 this norm was revoked.

As of January 1, 1998 social tax must also be paid on physical persons providing services under contract. Such payments have existed since April 1, 1993, when the section on Commitments in the Civil Law came into effect, which provided that such persons have entered legal employment relations. The Law "On Social Tax" which came into effect in 1996, changed this procedure, because it considered such persons to be self employed. These persons themselves registered as social tax payers and paid it themselves. Now, in the case of such relations, businesses will have to pay all the laid-down social insurance payments. In order for individual businesses to retain their relations with companies, they will need to register with the municipality at their place of permanent residence and obtain a patent or licence to perform individual work. Thus, these persons will become self employed and will pay their own taxes and insurance payments.

It should be noted that all socially insured persons will not be equally insured. The law provides for five types of insurance. Persons in some categories will be

Table 24 Rates for Persons Employed in Agriculture

Effective date	Employer's rate	Employee's rate	Paid from the national budget	Total rate
01.01.1996	22%	1%	15%	38%
01.07.1996	18%	5%	15%	38%

Table 25 Effect of Changes to the Law "On Social Tax" on SMEs Operations

No.	Date adopted	Type of normative act	Affected norms	Description of norms adopted	Effect
1	14.12.1990	New Law	All 10 Articles	■ Prior to passing this law, the matter was regulated by norms of Latvian SSR.	+
2	27.03.1991	Amendments	Article 3, Clause 3	■ Provides that in agricultural work and processing of farm products the employer pays a tax of 18.5% for his employees.	+
3	28.05.1991	Amendments	Article 3, Clause 2	■ Provides that the employer pays 8% for each employed disabled person;	+
			Article 4 Clause 1	■ Supplements that social tax is not added to payments made from pension funds registered with the Ministry of Social Security;	+
			Article 4, Clause 5	■ Deleted, thus reducing number of payments on which no social tax is paid;	–
			Article 5	■ Broadens provisions for paying social tax for the self-employed;	–
			Article 6.1	■ A new article providing for employers' duty to pay tax at higher for persons entitled to work pension;	– +
			Article 7.1	■ A new article, providing that no social tax is paid on income gained other than regular employment.	+
4	27.03.1994	Amendments	Article 7	■ Increases the rate for employees in the work-place entitling them to old age pension with relief conditions.	+
5	23.11.1995	New Law	All 15 Articles Transitional Provisions	■ Change in social tax rate to the benefit of the employer; the rate for employees and the self-employed is increased.	+
6	08.02.1996	Amendments for the Transitional period	Article 3	■ The deadline for equal rates is reduced by a year;	+
			Article 5	■ The deadline for new rates is reduced by six months;	+
				■ Contrary to Article 3, starting 01.01.2001 the rates are 18% and 15%, but these figures were supposed to be equal;	–
			Article 6	■ Relief for those employed in agriculture;	+
			Article 10	■ The list of professions engaged in agriculture must be approved by CM;	+
			Article 11	■ On the right of physical persons to pay the tax themselves for a bankrupt business in liquidation.	+
7	05.06.1996	Amendments	Article 4, Clause 1	■ A new article providing that no social tax is paid on labour insurance payments paid by the employer, but social tax is paid on life insurance payments for up to five years, and for health and accident insurance, for one year;	+ –
8	21.10.1997	New Law	All 26 Articles	■ The deadline for division of payment is extended, the rate is not reduced, the number of income on which tax is paid is increased;	– + – –
				Total"+"	11
				Total "–"	7
				Total "+ –" or "– +"	3

Table 26 Types of Compulsory Social Insurance and Their Applications

Persons subject to social insurance/ Type of compulsory social insurance	Pension	Unemployment	Industrial accidents, diseases	Disability pension	Maternity and sick benefits
Employees	+	+	+	+	+
Pensionable employees, disabled groups I and II	+	–	+	–	+
Soldiers on active service	+	+	–	–	–
Persons caring for a child under 1.5 yrs	+	+	–	–	–
Unemployed	+	–	–	–	–
Unemployed disabled	+	–	–	–	–
Persons drawing maternity or sick benefits	+	–	–	–	–
Self-employed persons	+	–	–	+	+
Spouses of diplomats and consuls working in other countries	+	–	–	–	–
Employees – foreign nationals, employed by a foreign taxpayer	+	–	–	+	+

insured for one or two types, others for three, as visibly shown in the following Table 26.

The mentioned issues are considered and applied pursuant to other RL laws and CM regulations:

- on state pensions,
- on social assistance,
- on compulsory social insurance covering industrial accidents and diseases,
- on maternity and sick benefits, and to
- CM regulations concerning application of the said laws and their specific provisions.

Finally it must be noted that although the law "On Social Tax" was repealed, application of this issue from the standpoint of business is not simplified, as the social payments, too, will remain in force and will not become less for either the employer or the employee.

Conclusions

The social tax is the heaviest burden of employers, especially SMEs. Employment of any person requires large additional expenditures. Under conditions of the existing low, average income, employees are yet unable to take care of their own social security. Changes in legislation for the most part touch on issues of tax rates. Reduced rates when employing the disabled and those employed in agriculture were a positive solution for SMEs, while extending payment conditions for the self-employed, taxing insurance payments and extending taxed objects were negative.

The new law adopted on November 23, 1995, "On Social Tax", providing a division of the tax rate as of July 1, 1996, failed to foresee that the move would result in reducing employees' income. Therefore on July 2, 1996 the CM adopted Regulations No. 245 providing that employees would be compensated for 4% of the increased tax. From the employers' standpoint this move had only one positive factor – this 4% could be written off as an expense linked to business operations, even though for a time it complicated their bookkeeping. Altogether, though, the burden of operating costs of SME employers increased, which cannot be considered a positive factor.

Corporate Income Tax

Corporate income tax is a tax levied on the income of various persons gained from business operations.

This is paid by:

1) residents – domestic companies carrying on business operations, public and religious organizations and institutions financed from the national and municipal budgets and gaining income from business operations;
2) non-residents – foreign companies, physical persons and others;
3) permanent representative offices of nonresidents, if carrying on business operations.

Corporate income tax is not paid by:

1) state enterprises, institutions financed from the national budget whose income is gained from business operations and is intended for a special budget part of the national budget;
2) institutions financed from municipal budgets whose income gained from business operations is intended for special municipal budgets;

3) non-profit organizations;
4) private pension funds;
5) partnerships where the partners pay income tax on their income;
6) physical persons;
7) individual businesses which do not file annual returns, as provided in the law "On Annual Reports of Companies.

Corporate income tax is levied on:

1) residents – taxable income received in Latvia and other countries during the current tax year, at 25%;
2) permanent representative offices of nonresidents – taxable income received in Latvia and other countries during the current tax year, at 25%;
3) non-residents – income received in Latvia by carrying on the same business operations as the non-resident's permanent representative office in Latvia. In this case, the non-resident's income received in Latvia is included in the income of the permanent representative office and is taxed at 25%;
4) non-residents – income from business operations or related operations, paid to the non-resident (also physical persons) by residents or non-residents' permanent representative offices, on the following types of income at the following rates:
   - dividends – 10%,
   - remuneration for management and consulting services – 10%,
   - companies and persons linked to paying of interest – 10%,
   - companies and persons linked to paying of interest by commercial banks registered in RL – 5%,
   - payment for intellectual property, literary or other art work – 15%,
   - other types – 5%,
   - remuneration for use of property – 5%,
   - sale of securities – 10%,
   - sale of real property – 25%.
5) payments made by permanent representative offices of residents and non-residents to countries and territories duly mentioned in CM Regulations, where there are low taxes or no taxes at all, and their representatives, at a rate of 25% (except cases where there is proof that the payment is justified and is not intended to reduce taxable income).

The regulation on corporate income tax exists since April 1, 1995, when the law adopted on February 9, 1995, "On Corporate Income Tax" came into effect, and revisions made to it later. Prior to that the law "On Profit Tax" passed on December 20, 1990 was in effect. Although the regulating law has now been given not only a new form but also content, its development is still linked to many amendments and revisions, searches for the new, corrections. The following Table 27 shows the development of the law and its evaluation.

The Effect of Taxes and Dues on Business

When considering the effect of taxes and dues on business, the most significant characteristics of the tax system must be noted:

1) the changing tax system, frequent changes in regulating norms and differing application;
2) a high rate of taxation and dues rates;
3) a low tax-free minimum;
4) an ineffective relief system;
5) a complicated calculation, payment and reporting systems;
6) an inefficient tax administration system;
7) a large proportion of exceptions in the application of norms;
8) regulating norms are not appropriately explained;

Such a system hinders business development in the country, because:

1) it is not in the best interests of business people to fully calcule and pay taxes;
2) conditions are not created which would raise an interest in developing competitive production both for the domestic and export markets;
3) the system does not ensure the preservation and effective use of natural and human resources;
4) the system does not ensure addressing social problems and implementation of principles of social fairness;
5) the system does not provide municipal budgets with the necessary financial resources;
6) the system does not provide for comprehensive collection of taxes;
7) the system does not promote saving.

Taxes and dues must perform the most important functions of promoting the social and economic development of the country by increasing employment. This can be achieved by reducing and differen-

Table 27 Effect of Changes to the Law "On Corporate Income Tax" on SME Operations

No.	Date adopted	Normative act	Applicable norms	Description of adopted forms	Effect
1	20.12.1990	New law	All	RL has its own law regulating corporate income tax. The following rates were laid down: ■ up to 10,000 Rubles – 15%; ■ 10,000 – 30,000 Rubles – 1,500 Rubles +25% of the amount over 10,000; ■ over 30,000 Rubles – 6,500 Rubles +35% of the amount over 30,000 Rubles; ■ income from Casino and slot machines taxable at 65%. Various relief was widely applied: ■ new businesses are given a tax holiday for the first two years; ■ a great number of discounts for different types of businesses, institutions, the disabled, companies with state capital shares etc.; ■ foreign companies and joint ventures where the foreign share is in excess of 30% are given a tax discount (100% and 50% respectively) for the first years of operations, as provided in the law "On Foreign Investment in the Republic of Latvia".	+
2		Amendments (04.09.1991)	Article 1	■ On taxing state and municipal income;	+
			Article 5	■ Correcting taxable income, reducing by road tax paid;	+
			Article 6, Clause 9	■ Including repairs to basic assets in expenditures;	+
			Article 6, Clause 10	■ Including loss and damages caused by contract parties in expenditures;	+
			Article 8, Clause 2	■ Correcting deductions from taxable profit in relation to amendments to Article 5;	+
			Article 11	■ Supplemented by including income gained from lotteries except RL state and charity lotteries;	+
			Article 13	■ Provides for inclusion of tax payable on profit of municipal enterprises to the national budget (40%);	–
			Article 15	■ Correcting municipal income tax portion;	–
			Article 20, Part 1	■ Taxing income of casinos, lotteries and casino companies as of start of operations;	+
			Article 23, Part 2	■ Taxing income of companies paying to funds, programmes etc. an amount smaller than the calculated tax;	–
			Article 24	■ Taxable income is reduced, excluding income gained from making and repairing spare parts of farm machinery;	+
			Article 29, Part 2	■ Entrusting functions to Ministries, providing opportunities to manoeuvre;	+ –
			Article 31	■ Determining maintenance costs of objects of social infrastructure according to normatives;	–
			Article 32	■ Applying discounts also to private businesses that have no state shares;	+
			Article 33	■ Increasing coefficient of gifts and donations, but reducing the total discount from 20 to 15%;	+

No.	Date adopted	Normative act	Applicable norms	Description of adopted forms	Effect
			Article 35, Part 2	■ Entrusts functions to Ministries, providing opportunities to manoeuvre;	–
			Article 30	■ Limits the amounts paid to develop sports.	+ –
3	15.04.1992	Amendments	New Article 3, Clause 1	■ Instructions to recalculate income and expenditures in foreign currency according to the BL exchange rate;	+ –
				■ Pay to taxes in foreign currency in proportion to investment in foreign currency.	– +
4	16.06.1992	Amendments and supplements	Article 4, Clause 9	■ The difference gained by selling foreign currency above the BL exchange rate included in income;	+
			Article 5	■ Amended wording;	+
			Article 6, Clause 11	■ Increased expenses section;	+
			Article 8, Clause 2	■ Reduces taxable profit by deducting customs payments;	+
			Article 10	■ Lays down profit tax rate according to minimum salaries;	+
			Article 20	■ Deletes profit tax holiday for new businesses, replacing it with tax reduction by amounts paid during the first three years of investment in manufacturing, and interest on long term loans to banks. If the business is terminated before having operated for four years, the tax is calculated in full;	–
			Article 22	■ Deletes relief for businesses of the disabled. Reduces taxable profit by amounts used to pay for losses occurred over the previous two years;	–
			Article 27	■ Deletes relief concerning supplies and services for the Government, provides relief for supplies and services pursuant to interstate agreements;	+
			Article 28	■ Increases relief for investment to manufacturing, reduces taxable profit by 50% (previously 30%) regarding amounts used for these purposes, and similarly permits deduction of payment of interest on long term loans;	–
			Article 32	■ Provides relief also for businesses with a municipal share;	+
			Article 39	■ Taxable profit is also reduced by amounts paid to internationally-recognized sports federations, but not star teams;	+
5	11.07.1992		Article 10	■ The previously differentiated rates set according to profit gained are revoked. Starting 01.10.1992 (!) the following rates were in effect: ■ for banks, businesses performing operations with foreign currency, insurance companies and trade companies, a 45% tax rate; ■ businesses and companies with a state or municipal share, except those previously mentioned, a 35% tax rate; ■ businesses and physical persons, a 25% tax rate; the minimum 15% tax rate is revoked;	–
			Article 18	■ Reduces relief for the total tax payable from 60% to 40% except in cases mentioned in Articles 20, 22, 24 and 28;	–

No.	Date adopted	Normative act	Applicable norms	Description of adopted forms	Effect
			Articles 21, 25, 32, 37, 38	■ Revokes relief for training, manufacturing and private businesses, companies with state or municipal shares, the Latgale programme and needs of minority national culture autonomy.	–
6	20.04.1993	Amendments and supplements to the law effective	Article 13	■ Revokes application of relief coefficient (2.85). Amount of relief is set in percentages (90%). Restriction of total payments from 20 to 15%;	–
		01.06.1993	Article 39	■ Relief is reduced for amounts used or paid to development of sports.	–
7	19.01.1994	Amendments to	Article 13	■ All profit tax is paid to the national budget;	– +
	19.01.1994	the law effective	Articles 14, 15, 16 and 17	■ Deletes articles regulating partial payment of taxes to municipal budgets.	– +
8	02.06.1994	Amendments to	Article 1	■ Supplements the word "company";	+
		the law effective 01.07.1994	Article 3	■ Amends wording referring to BL rate of exchange. Applies fluctuations in currency exchange rates as provided by the Ministry of Finance;	+
			Article 4, Clauses 1 and 2	■ New wording provides that income gained in other countries is included in taxable income, and that no tax is payable on dividends and insurance compensation not in excess of the amount of loss and damages;	–
			Article 6, Clause 1	■ The tax deductible amount is intended for purchase of stock is limited to Ls 50;	+
			Article 6, Clauses 3, 5, 7, 12, 13	■ Tax deductible expenses are increased, including costs of telephone, and passenger car costs, amortization of non-material investment and compulsory social security, costs of auditing the company's annual report and special savings of credit facilities;	–
			Article 6, Clause 8	■ Deletes tax deductible expenses from payments for employees' insurance and deletes costs of other physical and legal persons from tax deductible expenses;	+
			Article 23	■ Amends wording (Saeima, CM);	–
			Article 24	■ Reduces taxable profit by the portion of profit gained from fishing, processing fish and manufacture of spare parts for fishing technology;	+
			Article 31	■ Amends wording (CM);	+
			Article 32	■ Partially reinstates relief for donations to public cultural, educational, science, sports, charity, health and environmental protection funds, non-profit organizations, and internationally recognized sports federations where profit tax is reduced by 70% of payments made and their total does not exceed 10% of the taxable amount;	+
			Article 33	■ Relief rates are increased from 90% to 95% for donations to funds or programmes approved by the Saeima. Reduces total amount of payments from 15% to 10%;	+
			Article 3, Clause 1	■ Deleted, payment of taxes in other currencies is revoked;	+
			Article 27	■ Deleted, relief for work and supplies related to interstate agreements is revoked;	+
			Article 39	■ Deleted, relief is revoked for amounts used or paid to development of sports, construction of sports facilities and equipment.	–

No.	Date adopted	Normative act	Applicable norms	Description of adopted forms	Effect
9	09.02.1995	New law	All Articles	■ A new law "On Corporate Income Tax" came into effect on April 1, 1995, but its application was set for January 1, 1995. The new law has only 26 articles (41 in the previous law, but the law is broader in scope, regulates in more detail, includes definitions of terminology. The main specific of the law was a single corporate income tax rate of 25%.	+ –
10	10.12.1995	Amendments	Article 7	■ Reduces profit by tax-deductible amounts made to deposit insurance funds in accordance to funds for the protection of depositors' interests.	+
11	29.02.1996	Amendments	Article 3, Part 8 (new)	■ Tax is levied on all payments made to countries or territories where taxes are low or where there are no taxes at all, or the countries representatives delays;	+ –
			Article 3, Part 9 (new)	■ NRS may waive payment of taxes if it can be proved that such are not made for tax evasion purposes. In such cases tax rates applicable to nonresidents shall be applied;	+
			Article 6, Part 1, Clause 4	■ Increased taxable income in cases mentioned in Part 8 of Article 3 if no tax has been paid;	+
			Article 6, Paragraph 4	■ Additional reduction of taxable income on subsidies for agricultural production;	+
			Article 12, Paragraph 4	■ Supplement related to payments to persons residing in countries or territories where taxes are low or where there are no taxes at all, providing that transactions mentioned in Paragraph 8 of Article 3 apply not only to persons situated there but also to legal entities established or founded there;	+
			Article 24, Part 1	■ On tax payment at the moment of payment in cases provided in Paragraph 8 of Article 3;	+
12	05.06.1996	Amendments	Article 3, Paragraph 3	■ Delete the words "daughter company";	+ –
			Article 6, Part 1, Clause 6	■ A new clause, providing that taxable income is increased by the reserve fund for bad debts, but is reduced by amounts of debts written off during the tax year;	+ –
			Article 9	■ New wording defines conditions when taxable income is reduced by debts written off;	+
			Article 10	■ Corrections if income includes compensation received for land and/or buildings lost due to natural disasters or otherwise through forced conditions outside the taxpayer's control, if not invested;	+ –
			Article 13, Part 1, Clause 4	■ Correction related to value of remaining basic assets, which is increased by capital costs paid for basic assets of the relevant category during the tax year;	+ –
			Article 17,	■ Defines small business;	+
			Parts 1 and 3	■ Limits deductibles in cases when one person owns, or has considerable influence in, several small businesses;	–
			Article 19	■ Additional requirements for small companies employing prisoners;	+ –
			Article 22	■ Amendments regarding compulsory advance payments of taxes;	– +

No.	Date adopted	Normative act	Applicable norms	Description of adopted forms	Effect
			Transitional Provisions	■ This law applies to taxable income starting with the year 1996;	–
				■ Taxable income in 1996 may be reduced also by amounts lost by January 1, 1996 if these amounts have been written off on the company's books.	+
13	13.03.1997	Amendments	Article 2	■ Supplements re-application of the law to private pension funds; defines that physical persons and individual businesses which do not need to file annual reports, pay residents' income tax;	+
			Article 3, Part 7	■ New wording provides that the tax year is the same as the company's fiscal year;	+
			Article 6, Part 1, Clause 6	■ Defines wording on showing bad and writtenoff debts;	+
			Article 4, Part 4, Clauses 3, 4, 5	■ New clauses provide procedures for correcting taxable income regarding debts written off, value of purchase and sale price of certificates for investment in privatization, non-material value of the company;	+ –
			Article 6, Part 4, Clause 6	■ Supplements with reference to private pension funds;	+
			Article 6, Part 4, Clause 8	■ Defines increase of profit by amount of interest payments in excess of the permitted amount of interest which is calculated using the average short term interest rate set by the National Statistics Committee; this does not apply to interest payments to banks registered with the BL;	– +
			Article 6, Parts 11, 12, 13	■ New parts regulate the transfer and showing of losses of other companies and correction of taxable income; reduction of taxable income by payments made to private pension funds on behalf of employees;	+
			Article 9	■ Relates to bad debts;	+
			Article 13	■ The word "year" is replaced by "report period"; reference to amortization of basic assets in cases where the tax year is longer or shorter than 12 months;	+
			Article 14	■ The word "year" is replaced by "report period"; applicable to cases when a person obtains control of the company during the occurred taxation period during which losses have occurred;	+
			Article 14, Clause 1	■ New article regulates transfer of broad losses to a group of companies;	+
			Article 20	■ Definition changing February 1 in the taxation year to the first day of the second month of the taxation period, allowing that the taxation period may not correspond to the tax year;	+
			Article 23	■ New wording regulates taxation period, indexation and advance payments;	+ –
			Transitional Provisions	■ Back-dates application of amendments to the beginning of 1997.	–
14	13.11.1997	Amendments	Article 6, Part 8	■ Replacing the word "taxation" with the word "posttaxation" when considering corrections of taxable income;	+ –
			Article 6, Part 13	■ When arriving at the taxable income, taking into account payments to private pension funds, the company's profit may be reduced by the amount not exceeding 10% of the amount of employees' salaries during the taxation period;	–

No.	Date adopted	Normative act	Applicable norms	Description of adopted forms	Effect
			Article 13, Part 1, Clause 9	■ New clause providing coefficients of norms of amortization of basic assets in case of companies which operates in regions in need of special support, provided that a resolution has been adopted concerning the company, as provided by norms;	+
			Article 14, Parts 6 and 7	■ New parts providing that losses in the case of companies operating in regions in need of special support, provided that a resolution has been adopted concerning the company, as provided by norms, may be covered in chronological order from the taxable income of the next ten taxation periods; the aforesaid applies to losses of only those taxation periods when the region had the status of needing special support.	+
				Total "+"	53
				Total "–"	24
				Total "+ –" or "– +"	18

tiating tax rates, and granting relief. Increasing of the collectible tax amounts must be achieved by increasing the base of levies (additional residents' and corporate income, turnover of goods and services, etc.), not by increasing tax rates. It must take into account, however, that possible tax relief under conditions of a balanced market economy may be applied only with the aim of reducing the total costs of the employer (business). However, for the long term, lower taxes may have only a small effect on employment because the effect of low wages and salaries must be taken into account, as well as fluctuations in the social insurance system, and other factors.

The aims of tax relief and tax differentiation are to:

- create businesses incentives to invest in the areas of manufacturing, production, and service; introduce new technologies, produce competitive industries for the domestic and export markets; create new jobs;
- create favourable conditions for the development of priority sectors of the national economy (agriculture, processing, transport, ports, shipping, as well as efficient use of domestic raw materials and natural resources;
- increase taxes on industries harmful to health and the environment (alcohol, tobacco products);
- create favourable conditions for the improvement of material conditions for socially vulnerable groups (children, the disabled, pensioners), as well as development of education, science, culture and medicine.

Under such conditions, the role of tax administration grows because differentiation of taxes and a broad application of relief complicates it. But this is a national task, and it is possible to carry it out. Tax administration must consistently apply the principle of functions, planning to work especially with taxpayers not only during the process of paying taxes and afterwards, but especially at the stage before payment of taxes, when the required information must be submitted and explanations must be made. This will also increase the professionalism of tax administrators and strengthen control. Special attention must be given to the quality of auditing and monitoring, using professionals – sworn auditors, accounting experts, lawyers and other specialists. Tax administration must give special attention to the education of taxpayers, supplying them with materials, providing easier conditions for paying taxes and simplifying preparation of reports.

At present, the legislation permits norms regulating taxes to be changed constantly, and that these norms are interpreted with the help of instructions, directives, explanations and letters which are not acceptable from the standpoint of business. A business is unable to plan its operations for a longer period of time because there are no guarantees that the norms regulating it will not change. It should be stated strictly that only the Saeima may pass and amend laws, and not provide for application of Article 81 of the Constitution to make changes in laws. The Cabinet of Ministers passes regulations defining the application of the relevant law and collection of taxes. The National Revenue Service could issue additional instructions on the application or non-application of this or the other norm, but only if such instruction is signed by the Director General.

When perfecting the Latvian tax and dues system, it is recommended:

1) harmonize residents' and corporate income tax, introducing the progressive tax scale from 0% to 40%;
2) increase the tax-free amount for residents' income tax to at least the subsistence minimum;
3) not include in employees' income payments made by the employer on behalf of the employee (training, fares, health care costs, etc.), but rather include them in the cost of business operations of the employer;
4) for companies to maximally increase the scope of payments included in business operational costs and reduce conditions for increasing taxable income;
5) for SMEs to differentiate conditions for application of relief for their corporate income tax by increasing the deductible rate for small businesses to 50% and medium businesses to 25% of the amount of tax payable;
6) simplify the system for calculating social tax;
7) set differentiated rates for real property tax, from 0.1% to 1.5%;
8) provide that the NRS pay late charges on overpaid taxes not re-imbursed in time, at the same rates the NRS charges;
9) reduce deadlines for re-imbursing overpaid taxes;
10) when a company registers as a taxpayer, the NRS must provide it with illustrative information regarding all tax payments, their deadlines and a list of applicable normative acts, which must then be constantly updated and forwarded to companies free of charge;
11) regularly train tax inspectors and, involving independent evaluators, carry out re-attestation, as for example, the annual re-attestation of police drivers, performed by professional teachers of private driving schools;
12) establish an efficient tripartite co-ordination system, so that the government listens to the views of employers and employees on planned changes in tax legislation before drafting same;

Only when implementing these recommendations for achieving the aforesaid aims and tasks will the country enjoy a business environment favourable to business, where companies will not practice tax evasion but will be interested in the development of their company and the country as a whole and improvement of economic and social conditions whose aim is to raise the living standards of all residents of Latvia.

Conclusions

In considering the changes to income tax levying legislation, it must be concluded that there have been twice as many positive than negative individual changes. However, has this been to the benefit of both sides? Looking at the proportion of corporate income tax in the total national revenue, it is obvious that a certain stagnation can be observed in this matter – companies try to pay a little regularly, failing to show their real profit. This situation may be explained that the payer, if he pays, gains no gratification from doing so. To pay or not to pay taxes – in essence, nobody receives a gratification from it. To pay or not to pay taxes – it really makes no difference. Companies also lack reassurance that the tax revenue is rationally used, including improving the business environment.

The following could be changed to make payment of corporate income tax beneficial or at least acceptable to both sides:

1. differentiating tax rates, depending on the taxable income, with opportunity to reduce the rate when a specific level of taxable income is reached;
2. setting a tax free amount for businesses and companies;
3. tax holidays for newly established SMEs;
4. reducing taxable income by the amount invested in business development – purchase of more up-to-date technology, equipment, etc.;
5. reducing taxable income (or total tax payable) by a specific amount if the business or company creates new jobs and, for example, has not reduced same during the taxation year.

Issues of Ownership

Land Legislation

After the renewal of independence of the RL, drafting of real property legislation was started November 21, 1990 with the law passed by the Supreme Council of RL, "On Land Reform in Rural Areas". The law announced land reforms in rural areas, intending to renew ownership rights to previous owners, and to provide rights to other persons to obtain land for use and later purchase. Previous owners, too, first had to obtain the land. It was planned to transfer ownership of land to Latvian citizens only. Although applications to obtain land for use had to be submitted by June 20, 1991, the reform was planned to be completed in ten to fifteen years. Municipalities of *pagasts* (an administrative area roughly corresponding to a parish) were entrusted with the decision making concerning land.

From the viewpoint of SMEs, this law was important for two reasons:

1) it created a legal basis for the development of farm holdings and other small rural businesses;
2) it sowed the first seeds in the real property market.

On October 30, 1991 the laws "On Returning Buildings to their Legal Owners" and "On Denationalization of Buildings in the Republic of Latvia" were adopted. These laws provided for the renewal of ownership rights to previous owners (or their heirs). In cases when the building had been taken over by the state according to legal acts on nationalization, denationalization had to be carried out by regional municipalities, which passed resolutions based on the findings of denationalization commissions. In other cases adoption of a resolution was within the competence of the courts. Ownership rights were renewed both administratively and through the courts if the application was made within three years of adoption of the law. Buildings sold to purchasers in good faith by a notarized contract were not returned. The Council of Ministers was required to set the maximum rent for these buildings, and it was prohibited to evict tenants within the next seven years without providing other living space.

From the viewpoint of SMEs, these legal acts continued movement toward aligning the real property market and opened opportunities for the development of a new type of business – management of real property, as well as a large number of premises included in the civil rights circulation, which was an important factor at the initial stage of business development when many SMEs faced a serious problem in finding office and manufacturing space. On November 20, 1991 the law "On Land Reform in Towns and Cities of the RL" was passed, which provided for renewal of ownership rights to previous land owners and their heirs (regardless of citizenship). The deadline for submitting applications was set for June 20, 1992. The law contained a condition that in the event of failure to submit such an application, the previous owner retained the right to renew ownership rights for the next ten years, and during this time land may be allocated for use only. Later, this norm was replaced by a condition that, in the event an application was not submitted by June 20, 1992, ownership rights could be renewed by the courts. As opposed to rural areas, renewal of ownership rights in towns was not linked to use of land. From the viewpoint of business, including SME, this law supplemented the laws on return of buildings, including land in the civil rights circulation (which could not be privately owned or be the object of a transaction during the Soviet regime).

The prohibition that foreign nationals and legal persons may not obtain land as a result of a transaction, and the fact that return of the land and the buildings was regulated by three different laws each providing different procedures, was considered of negative value. On July 7, 1992 the section on rights of real-estate owners in the RL 1937 Civil Law was re-enacted, and became the blanket law regarding the legal regulation of ownership rights. An opportunity for different owners of land and buildings was accepted, which was important for those many SMEs which had by privatization obtained ownership of state and municipal property which had been built during the Soviet regime on land of previous owners. Unfortunately, the issue of legal persons obtaining land to own was not addressed. The first right of refusal of municipalities to purchase land provided in the law "On Land Reform in Towns and Cities of the RL" was extended and made applicable to real property in general, which can be considered a condition encumbering application of the Civil Law.

The law adopted on July 9, 1992 "On Privatization of Land in Rural Areas" supplemented the law of 1990, "On Land Reform in Rural Areas". The law provided the opportunity to renew ownership rights to land without providing conditions precedent for allocating land to use or providing for submission of

Table 28 Changes to Land Legislation and Their Effect on SME Operations

Title of Act	Content of amendments	Effect on SME
Law of SCR "On Land Reform in Rural Areas" (21.11.1990)	■ Provides for land reform in the country and emergence of land ownership;	+
	■ Provides that reforms be carried out in two waves (allocating for use and allocating to own the land allocated for use);	–
	■ Intends to allocate land to own only to RL citizens and with the approval of the Land Commission of SC;	–
	■ Sets a deadline of June 20, 1991 for submitting applications for use.	–
Law of SCR "On Denationalization of buildings" and "On Returning Ownership of Buildings to Legal Owners" (30.10.1991)	■ Provides for renewal of ownership to practically all buildings confiscated or nationalized during the Soviet regime;	+
	■ Provides that tenants could not be evicted from these buildings for seven years from the date of renewal of ownership.	–
Law of SCR "On Land Reform in towns and cities of RL" (30.10.1991)	■ Provides for renewal of ownership rights to previous land owners or their heirs regardless of their citizenship;	+
	■ Provides the procedure for purchase of land;	+
	■ Does not provide for opportunities for legal persons and non-citizens to own land.	–
SCR law "On the Time and Procedure for Taking Effect of the Introduction, Inheritance Rights and Rights of Things (res) of the Renewed 1937 RL Civil Law"	■ The partial renewal of the 1937 Civil Law introduces legal norms which regulate issues of rights of things (res) according to world praxis;	+
	■ Provides that land and buildings may be owned by different owners;	+
	■ Provides that municipalities may have first right of refusal in transactions concerning real property.	–
SCR law "On Privatization of – Land in Rural Areas" (09.07.1992)	■ Provides for renewal of ownership rights to land in rural areas without the mandatory condition precedent of first allocating the land for use;	+
	■ Provides a procedure for privatizing land that has been allocated for use;	+
	■ Retains the provision that rural land may be owned by RL citizens only.	–
SCR law "On Reenacting the December 22,1937 Land Books Law and Procedure for it Coming into Force" (30.03.1993)	■ Introduces a legal registration system for real property including mortgages and other encumbrances;	+
	■ Provides for a complex and expensive procedure for the initial registration of ownership rights.	–
SCR Law "On Amendments to the Law "On Land Reform in Towns and Cities of RL" (24.11.1994) and "On Amendments to the Law "On Privatization of Land in Rural Areas" (08.12.1994);	■ Provides an opportunity for certain categories of companies registered in Latvia or other countries to purchase land in the territory of Latvia;	+
	■ Provides for the necessity to obtain approval of the Central Land Commission for there transactions.	–
Law of the RL Saeima "On Ownership Rights of the State and Municipalities and Their Registration in Land Books" (29.03.1995)	■ Separates ownership rights of the State and municipalities to real property and provides the procedure for their legal registration	+
Amendments to the Law "On the Renewal of Force of the 22.12.1937 Law on Land Books and Procedure for it Taking Effect (27.04.1995 and (04.09.1995)	■ Permits registration of buildings in the Land Books prior to registration of the land lot in cases where there are different owners and ownership to the land has not yet been registered, also register ownership to buildings which have changed their owner since renewal of the Law on Land Books	+
CM Regulations "On Registering Real Property in Land Books" (10.04.1996), passed by the Saeima into law on 30.01.1997	■ Simplifies certain issues which relate to registration of real property in Land Books	+

Title of Act	Comment of changes	Effect
Laws of the RL Saeima "Amendments to the Law "On Land Reform in Towns and Cities of RL" (08.05.1997) and "Amendments to the Law "On Privatization of Land in Rural Areas" (05.12.1996)	■ Extends the scope of legal persons entitled to obtain land to own without restrictions;	+
	■ Provides that other physical and legal persons may obtain land (except agricultural, forest, border zone and protective zone land) to own with municipal approval.	+
	Total "+"	15
	Total "–"	9
	Total "+ –" or "– +"	24

applications after June 20, 1991. Furthermore, the law provided a procedure for users of land who were not previous owners or their heirs to purchase land allocated to them for use, using privatization certificates, intending that allocation of land for use may continue to November 1, 1996. Both in urban and rural areas, resolutions to renew ownership rights or granting ownership for payment were adopted by the relevant municipality based on the findings of the Land Commission of the municipality (in September 1995 the legislators delegated the authority to make final decisions to municipal Land Commissions). It was still not provided that legal persons could purchase land. Thus, from the viewpoint of SMEs, this law did not essentially change the situation, and only because of accelerating the renewal of ownership rights did owners (partners) have more opportunity to use the real property to secure loans to develop business operations.

On March 30, 1993, the 1937 Law on Land Books was put back into force, thus providing procedures for legal registration of real property (ownership rights, mortgages, encumbrances). Registration operations were entrusted to Land Books Branches of Regional courts. Although a stable legal registration system of real property is important from the viewpoint of SMEs because it determines access to mortgage loans, the aforesaid law provided for a complicated, lengthy and expensive registration process. A new heretofore non-existent institution was established, which added to the already existing number of institutions involved in issues of real property (the various municipal institutions making decisions to renew ownership rights, the State Land Service, which surveyed land lots and assessed property, the Mortgage and Land Bank which made agreements to sell land on behalf of the state). According to the law, applications for the initial entry of real property in the Land Books had to be handled within thirty days, but applications to register ownership rights as a result of a transaction had to be handled not later than the day after receipt of application.

In practice, Land Books branches ignored this norm, especially because of their work load. Therefore, in reality, any action related to registration of ownership rights was performed within twenty to thirty days. Registration of buildings in the Land Books was possible only after registration of the land lot, or simultaneously. If the land and the building had different owners, this fact blocked the registration of the rights of the owner of the building. This norm affected the interests of all companies which had constructed something prior to the adoption of this law, or had privatized a building on another's land. In addition, it was provided that transactions made after April 5, 1993 (namely, the day the effectiveness of the Land Books Law was renewed) may not be the reason for registration of ownership rights, if the rights of the previous owner had not been registered in the Land Books. This norm, too, essentially slowed down completion of transactions and affected the interests of SMEs whose operations were linked to the use of real property.

On November 24, 1994 the Saeima made changes to the law "On Land Reform in Towns and Cities of RL", providing that companies registered in Latvia in which more than half of the basic capital was held by a Latvian citizen, or by foreign companies of countries with which Latvia has signed agreements, which were in force for the promotion and protection of investments, could obtain ownership of land registered in the Land Books. In order to close a transaction, approval had to be obtained from the Central Land Commission (refusal could be appealed in court). Legal persons could not own land in the border and defence zone, and agricultural and forest land in accordance with the general plan of the town or city. Even though there were restrictions and conditions, these changes were a step toward liberating the land market and prevented the silly situation where

companies (including SMEs) were entitled to purchase buildings but not land). It must be noted, however, that in most SMEs with foreign capital, Latvian citizens did not hold more than 50% of the basic capital, and therefore the improvement benefited only some companies.

Similar changes were made on December 8, 1994 to the law "On Land Reform in Rural Areas". The law, adopted on March 23, 1995, "On Ownership Rights of State and Municipalities and their Registration in the Land Books" provided a procedure for registration of ownership rights of the state and municipalities and determined the owner of the land lot – the state or a municipality, guided by a number of criteria (ownership at the moment of nationalization, existence of buildings on the land lot, etc.). From the viewpoint of SMEs this law was important because it permitted legal registration of those land lots which were not returned to previous owners, and which frequently were occupied by various manufacturing facilities (built during the land reform or privatized). Aligning of ownership rights to land opened the way for legal registration of buildings in the name of SMEs. In addition, a number of state and municipal real properties not needed by the relevant institutions for the performance of their specific functions were offered for sale after registration in the Land Books, thus increasing the supply in the real property market and partially reducing prices, and this was in the interest of SMEs.

In turn, in April and September of 1995 changes were made to the law "On the Renewal and Coming into Effect of the RL 1937 Land Books Law" The changes made in April permitted legal registration of buildings even if the land under it was not yet entered in the Land Books and even if it had a different owner. Changes made in September permitted registration of ownership rights to buildings obtained as a result of a transaction after April 5, 1993, also in cases when the seller's ownership rights had not been registered, provided the purchaser could produce documents proving the seller's rights. Both these changes revoked the previous restrictions, which made operations of purchasers of buildings difficult and affected many companies (mainly SMEs) which had purchased manufacturing facilities or other buildings during the post-independence period, and were unable to register their property rights only because ownership of the land lot was unclear. The Cabinet of Ministers Regulations adopted in April 1996 "On Entering Real Property in Land Books", revoked the need for mandatory approval of the land owner or lessor for the building to be legally registered in cases where buildings and land were owned by different persons. On December 5, 1996 and May 8, 1997 changes were made to the laws "On Privatization of Land in Rural Areas" and "On Land Reform in Towns and Cities of the Republic of Latvia", which liberated the legislation even more regarding opportunities to purchase land. According to these changes any land lot registered in the Land Books could be purchased by:

1) public joint stock companies;
2) companies where more than 50% of the capital is owned by:
   - Latvian citizens, the state, or municipalities;
   - physical and legal persons from countries (totalling eighteen) with which Latvia had signed interstate agreements for the promotion and protection of investments, provided these agreements have been approved by the Saeima by December 31, 1996. If such agreements were made later, they had to provide for rights of Latvian citizens to purchase land in the country in question (it should be noted here that interstate agreements never provide this clause and therefore this norm in fact will never be applied in practice);
   - subjects of the above clauses jointly.

All other physical and legal persons may purchase land with the approval of the head of the local municipality. Furthermore, land in border zones, protective zones of public waters and land of agricultural and forest use (according to the general territorial plan) may not be purchased by subjects of the "second category" at all. Thus most of the land outside urban areas is practically not available to them.

However, when it is necessary to obtain municipal approval, one must frequently face a situation where no answer is provided during the twenty day period proscribed by law. Without question, these changes, which significantly extended rights of companies to purchase land, significantly improved the situation of companies in the area of real property. They were of special importance to SMEs because they broadened their opportunities to purchase or privatize the land under privatized or erected facilities which in turn significantly increased the mortgage opportunities of these companies, which in the case of SMEs is the only way to obtain funds to develop their operations.

Conclusions and Recommendations

Even though the present situation in the area of real property may be considered favourable to business from the legal and also SME point of view, it should be considered, however, to repeal all the still existing restrictions in the area of land purchase as well as the need to obtain municipal approval.

The civil rights circulation was also slowed by the first right of refusal of municipalities in the sale of real property, which is never applied in practice, but encumbers parties with additional procedures. The possibility of revoking the right of refusal should be considered.

From the viewpoint of land reform and legal registration of property, the possibility of establishing a single government institution performing functions of renewal of ownership rights, inventory and legal registration should be considered. Thus, a situation could be prevented that documents required to complete a transaction involving real property must be obtained from four or five different institutions, all of which increase the indirect costs of SMEs and require considerable time, effort and money.

The time for registration of property rights by registration institutions should also be shortened.

Intellectual Property

Development of Latvian legislation in the area of intellectual property was in fact started afresh after renewal of independence on May 4, 1990, because during the Soviet regime, when any civil operation was very limited, legal protection of intellectual property did not exist. The Supreme Council of the Republic of Latvia (Parliament) required the government in the fall of 1991 to take the necessary steps to establish a Patents Board, but in reality the Patents Board began operations only in the Summer of 1992. It should be noted that during this period registration procedures and issues of protection of ownership rights of intellectual property by legal means were not aligned and the newly established Patents Board was guided in its operations by the practice implemented in the USSR and instructions of internal services. On May 28, 1992, by government order, payment of fees was determined for services of the Patents Board. The resolution provided for application of two different rates. Latvian citizens were to pay between 250 and 950 Latvian Rubles ($ 1 corresponded to approximately 200 Latvian Rubles) for services at the Patents Board (application for a patent, application to the Appeals Council, issuing the patent, replacing a USSR patent with a Latvian patent, issuing a copy of a patent, etc.). On the other hand, foreign nationals had to pay $ 20–75 for the same services. A similar situation existed regarding payment for protection of trademarks and industrial samples. From the viewpoint of residents of Latvia, including SMEs, the setting of such minimum rates was a positive factor, however discrimination of foreign nationals must be considered negative.

Although in fact the Patents Board had been in operation since the Summer of 1992, the patent law was enacted on March 2, 1993. The law provided that the subject of a patent is an invention which is new, may be used in industry and complies with the meaning of invention. It should be borne in mind that subjects of rights to industrial property are mainly physical persons, and therefore legislation in this area applies to the interests of companies, including SMEs, only indirectly. For example, the patent law provided that employers are entitled to company inventions, namely inventions generated by an employee while performing work pursuant to a labour contract. It is the duty of the employee to notify the employer of the invention immediately, but the employer forfeits its rights if it does not advise the employee of its intention to take advantage of its rights. From the viewpoint of SMEs, the existence of this norm in the law can be considered positively, because it defines the relations of employer and employee in an area which may be related to considerable financial disputes.

The law provided the following procedure for issuing a patent. The person who wishes to obtain a patent applies to the Patents Board, providing a description of the invention. The Patents Board completes the initial assessment of the application within three months. If the application is rejected at the initial stage of consideration, the decision may be appealed to the Appeals Council. If the application is accepted, a notice is published to this effect eighteen months after application is made. Four months after the publication of the notice a decision is taken to issue a patent. Within nine months of publication of the notice that a patent is issued, any person may submit objections to the Appeals Council. The decision of the Appeals Council may be appealed in court. From the viewpoint of SMEs, the long periods in the registration process may be viewed as a negative factor, however, it should be noted that the periods provided in the law essentially correspond to those in international practice. The law also provided for the

Table 29 The Effect of Intellectual Property Legislation on SME Operations

Title of act	Article	Content of changes	Effect
SCR resolution "On Renewal of RL Patents Board" (26.11.1991)	2	■ Orders the CM to renew operations of the Patents Board by 15.12.1991;	+
	3	■ Orders registration of industrial property to begin as of 01.01.1992 for purposes of protection.	+
CMRL resolution No. 55 (19.02.1992) "On Establishing RL Patents Board"	3	■ Provides that the purpose of the Patents Board is the protection of industrial property and maintenance of appropriate national registers (for inventions, industrial samples, trade marks).	+
CMRL resolution No. 194 (28.05.1992) "On Fees payable for services of the Patents Board"	1	■ Provides for differentiated rates for services of the Patents Board depending on whether the recipient of the services is a Latvian citizen (fees for the same services provided to foreign nationals are considerably higher).	+ –
Patents law (02.03.1993)	4.5	■ Provides for inventors' rights to patents, as well as employers' rights to company inventions;	+
	7–13	■ Provides a procedure for applying for a patent and reviewing of the application;	+
	14–18	■ Provides international applications for a patent and procedure of the European patent registration;	+
	31	■ Provides a twenty year protection period for patents rights;	+
	39	■ Provides for a possibility of a forced application for a patent.	–
Law "On Trade Marks" (09.03.1993)	4–11	■ Provides a procedure for registration of trade marks, which is essentially the same as the procedure for patents;	+
	12	■ Provides that the period of registration of trade marks is ten years, with option to renew registration for an indefinite number of years.	+
Law for the Protection of Designs (04.05.1993)	7–13	■ Provides a procedure for patenting design samples, which is essentially the same as for patents;	+
	11	■ Provides that patents are issued for ten years, with option to renew twice.	+ –
Law on Copyright and Ancillary Rights (11.05.1993)	4	■ Defines subjects of copyright, providing that these rights are effective without special registration;	+
	13–27	■ Defines content, scope and restrictions of copyright;	+
	28–30	■ Provides expiry periods for copyrights.	+
Patent law (30.03.1995)	14–20 46–49	■ Introduces supplements and definitions regarding international patent applications and European patents;	+
		■ Introduces a complex procedure for hearing disputes in court.	+
CM Regulations (11.08.1998) "On Copyright and Ancillary Rights"		■ This act, which was intended to replace the same law passed May 11, 1993, became null and void on November 3, 1998 because of failure to observe the legislative process.	–
CM Regulations (18.08.1998) "On State fee for protection of industrial property"	2–4	■ Increases the rates of fees compared to those set in 1992;	–
	5	■ Provides for reduction of fees paid by physical persons.	+
		Total "+"	16
		Total "–"	3
		Total "+ –" or "– +"	2

submission of international patent applications, as well as made it possible to have patents registered in Europe enforceable in Latvia. The law provided a twenty year period for the protection of a patented invention, as well as provided for a forced issue of a patent in the event the inventor did not use his invention within four years. The decision to issue a forced patent may be made by the court following application by any person. From the viewpoint of SMEs, formally the existence of such a norm must be considered negatively, because an SME holding a patent may well face financial problems delaying the practical application of the invention. In reality this norm has never been applied in Latvia.

Almost simultaneously with the patent law the law "On Trademarks" and the law on "Protection of

Design Samples" were adopted. Pursuant to these laws, the Patents Board was required to register trademarks and patents of design samples (the exterior form of a product created as a result of artistic planning). Basically the procedure corresponded to the procedure for patenting inventions, but differed in considerably shorter deadlines. The Patents Board had to review applications to register trademarks within two months, but applications concerning a design sample within three months. With respect to submitting objections, the law provided for a six month period in the case of design samples, and three months in the case of trademarks, starting with the day of publication of the relevant notice by the Patents Board. The law protects rights of the holder of a patent for design sample for five years, with the option to extend this period twice for another five years, by repeated registration. Trademarks are registered for ten years. The law does not provide for use of force against the holder of a patent for a design sample if the design sample is not used. If the design sample was created while working for an employer, the same procedure applies as for patenting an invention, but the employer forfeits its rights if it fails to take advantage of it within four months. From the viewpoint of SMEs this regulation can be considered positively.

The law adopted in 1993 "On Copyright and Ancillary Rights" defined the rights of persons to products created as a result of intellectual activities (books, music, computer programmes etc.). The law divided copyrighted into material and personal rights. Furthermore, the personal rights of an author (rights to the author's name, publication of the work, inviolability of the work) are held by the author even if the material rights are transferred to other persons pursuant to an agreement with the author. The law provided that the copyright remains in effect during the lifetime of the author and fifty years after the author's death. An exception concerns audio video work, where copyright remains in effect fifty years after publication of the work. Since the norms of rights contained in the law "On Copyright and Ancillary Rights" regulates the rights of the author – a physical person and does not involve normatives directly affecting business, from the viewpoint of SMEs these may be considered neutrally. An exception here may be the precedent incorporated in the law providing that in the event of a further sale of a public work of fine arts, the author must be paid 5% of such sale proceeds. From the point of view of SMEs, a problem may be caused not by the insufficiency of the norms of the law, but rather the inability to ensure protection of the interests of copyright and, especially, ancillary rights (performers, producers and broadcasting organizations of phonograms) against violators of rights and market protection against the illegal trade of purloined copies.

It should also be noted that a new Patents law was passed in 1995 which replaced the Patent law passed in 1993. This law defined individual procedures, among them, the application of European patents in Latvia, but did not introduce any significant changes, especially ones that would be important from the viewpoint of SMEs. A negative factor may be considered the complex addressing of disputes in court incorporated in the law.

From the viewpoint of SMEs, without a question a negative factor are the CM Regulations adopted in 1998 "On State Fees Payable for Protection of Industrial Property", which replaced the rates set in 1992 for services of the Patents Board. For residents of Latvia these regulations considerably increased costs for legal protection. For example, the fee for application for a patent increased from Ls 5 to Ls 50, the fee for application for a trademark from Ls 3.50 to Ls 60 and so on. As any increase in taxes and other mandatory payments, the increase of these fees, too, must be considered negatively, because slowed the civil rights area.

Conclusions and Recommendations

1. From the standpoint of business development, it is important to establish a mechanism for legal control that would prevent the massive violations of copyright that can be observed in Latvia at this time.
2. It is desirable that fees for the protection of industrial property be reduced.

Access to Financial Resources

International Currency Operations

Freedom of currency transactions is an important support for the national business. During the Soviet regime a strict state control existed over currency operations, and only during the last three years of its existence did the USSR government begin to give up

its monopoly rights in the area of international payments. Persons involved in foreign trade relations had to pay currency into the funds of the CM of LSSR or Executive Committees. The Latvian government considered liberation of the currency market one of the first issues that needed addressing in order to realize economic independence. The first step was the establishment of a Foreign Trade Bank (Order of CM RL No. 178 of 28.04.1990), to take over control of currency operations from the USSR government. At first the Latvian government attempted to monitor receiving and use of foreign currency in Latvia, payments of persons involved in foreign trade relations to their foreign partners, but such control failed to give the expected results because the government was unable to completely follow the financial activities of people involved in foreign trade.

Companies found ways to open accounts in foreign credit facilities. It is obvious that any control over financial transactions needs to be ensured with the help of an accounting system rather than by directly controlling the cash flow. A logical step was the Resolution of SCR "On Steps Toward Establishing a Currency Market in RL" adopted on November 29, 1990. Since January 1, 1991 open purchase and sale of foreign currency was permitted, determining of exchange rates was left to private business, and soon the Parex bank became the largest entity in the currency market. The Bank of Latvia merely noted the previous day's purchase and sale rates. Such a passive role on the part of the central bank was logical, because the transitional currency – the Latvian Ruble – was introduced only in 1992, and the Bank of Latvia had neither the opportunity nor the need to support the Soviet Ruble. The opportunities provided in the Resolution to pay salaries in foreign currency reduced the additional costs of companies (conversion) and increased the competitiveness of these companies, allowing them to attract quality staff with their additional advantages. The CM was given the authority to limit export and import operations of companies which used their own accounts in foreign banks to make payments for their transactions, which turned out to be rather complicated because of the weak control system and thus did not cause any significant difficulties. It should be noted that attempts to dictate to businesses where to keep their money or how to use it promoted development of the shadow economy, and the control caused additional costs on the part of the government.

The next attempt by the government to attract foreign currency resources to banks registered in the RL and to control the currency flow of businesses was the CMRL order No. 352 issued in September 1991, which required all businesses, companies and organizations in the RL to open currency accounts with banks registered with the BL only and to transfer balances from their existing accounts in foreign banks by December 31, 1991. Such action must be considered a way to compensate the incapability of the government with methods of force, and its effect on business can only be considered as wholly negative.

Restrictions on currency transactions were revoked in 1992 at the time of introduction of the transitional national currency. At present freedom of currency transactions is practiced in the country, businesses involved in foreign trade are not restricted in having accounts in foreign banks and no additional funds are withheld for the benefit of government or municipal funds. Currency transactions are controlled with the help of accounting and tax systems, without geographic restrictions.

Fiscal Policy

After renewal of independence Latvia found herself in the USSR ruble zone, and therefore the introduction of a national currency was deemed to be one of the basic tasks of the government. The first

Table 30 Regulation of Currency Operations

Title of Act on SME	Contents of changes	Effect
CM RL Order No. 178 28.04.1990	■ In future currency payments could only be made through the LSSR Foreign Trade Bank.	– +
SC RL resolution "On Measures to Establish a RL Currency Market" 29.11.1990	■ Beginning January 1, 1991 free purchase and sale of foreign currency was permitted; ■ Restrictions on companies which had bank accounts in other countries; ■ Salaries could be paid in foreign currency.	+ – +
CM RL order No. 352 06.09.1991	■ All RL companies should have open currency accounts only with banking institutions registered with the Bank of Latvia.	–

step establishing (renewing) a central bank was taken on March 2, 1990, when the SCR passed the law "On Banks", which provided for the establishing of a central bank – a center for emission of money, a bank which, as opposed to commercial banks, organizes performance of the national budget and regulates the economy with instruments of fiscal policy. The Bank of Latvia established issuances, functions, and authority of an independent central bank after passage of the 1991 SCR Resolution "On Reorganization of Banking Facilities in the Territory of the Republic of Latvia" and the law passed in May 1992 "On the Bank of Latvia".

The Resolution of SCR passed on July 31, 1990 "On a Programme Establishing a Monetary System for the Republic of Latvia" was the first step toward renewing a Latvian national currency. A Committee for the reform of money was formed. On May 7, 1992 the Latvian ruble was issued, which became on July 20 of the same year the sole acceptable form of payment. The exit from the Soviet ruble zone was linked to a number of actual and psychological problems, all of which caused a distrust of the new currency. As business developed in the LSSR and later the RL, the unstable local currency encouraged closing transactions in foreign currencies, basically the American Dollar. This trend has not completely disappeared even at present, especially on the "black market".

When changing to the historic national currency – *lats* – it was necessary to gain the trust of the residents of Latvia. The Latvian ruble had survived increased inflation, the Bank of Latvia had strengthened its position and prepared itself for the issue of the new national currency. Although later than some neighbouring countries, yet successfully and professionally, on March 5, 1993 emission of the Five lat banknotes was started. One Lat equalled 200 rubles which stopped being a form of payment only on October 18, 1993. The gradual and well-considered currency transition process had considerably fewer problems, compared to the 1992 reform. Without a doubt, the repeated change of the official form of payment made things difficult for business, caused additional costs, but the risk to change directly from the USSR ruble to lats was too great.

At first the lats was floated and the Bank of Latvia affected it when necessary by currency intervention. In creating a currency rate, in February 1994, the lat was tied to SDR (1 SDR = 0.7997 LVL). The tie was unofficial and was applied as a part of the independent monetary policy of the Bank of Latvia. The Bank of Latvia determined the official currency purchase and sale rates and undertook to sell to commercial banks on demand any amount of currency of the SDR basket.

The monetary policy of the Bank of Latvia is based on the following basic principles:

- open conversion of the national currency;
- unrestricted capital flow;
- external stability of the national currency;
- internal stability by ensuring the lowest possible inflation;
- interest rate policy providing additional control over liquidity.

In establishing a strong and independent monetary policy, the Bank of Latvia was able to retain both legal and actual independence from the government and parliament. The Bank of Latvia has been criticized by some businessmen and politicians for the overly high rate of the lat, saying that it threatens manufacture and export, but experts at the World Bank and the Bank of Latvia point out the artificially

Table 31 Transition to a National Currency

Title of Act	Contents of changes	Effect on SME
Resolution of the RL Money Reform Committee (MRC) No. 1 "On Introduction of the Latvian Ruble into Circulation" (04.05.1992)	■ Provided that a national currency for the transitional period be introduced	+
Law "On the Bank of Latvia" 19.05.1992	■ BL is granted broad authority and independence in realizing monetary policy	+
Resolution of the RL MRC No. 4 "On Guarantees during transition to a national currency – Lats" 31.08.1992	■ All Latvian Rubles currently in circulation will be exchanged for Lats	+
Resolution of the RL MRC No. 5 "On introducing a Five Lats note into circulation" 12.02.1993	■ Provided that emission of Lats be started	+

reduced value of the lat. In this case not only the views of different specialists are in conflict, but also various macro-economics theories, and thus the authors of this study shall refrain from giving more extensive comment.

Availability of Credit (Loans)

Availability of favourable credit resources is an extremely important factor in SME development. SMEs are usually characterized by limited funds, which are wholly tied up in current operations (turnover funds), and either there are no funds at all for further development or they are not sufficient to carry out serious projects. When developing SMEs with their own funds alone, the pace of development is slow, and in fact, a certain stagnation can be frequently observed.

Availability of credit is linked to development of credit facilities. The first legal act which provided establishment of private credit facilities was the LSSR law of March 2, 1990 "On Banks". The law provided a rather odd definition of the meaning of a bank, "A bank is a specific economic organization which ensures the functioning of cash turnover and a loans fund". The LSSR banking system was formed by the following: the LSSR central bank, state commercial banks, other commercial banks and other credit facilities recognized as such in the statutes of the BL. Thus, businesses in the private sector came under the heading, "other categories". The procedure for establishing commercial banks is described in some detail in Section III, but the procedure for establishing credit facilities was left to the Bank of Latvia. The law does not contain essential norms concerning credit policy, but it can be considered a first step toward establishing a system of "pocket banks" in Latvia. Later changes and supplements to the law concerned the legal status of the Bank of Latvia and did not address issues of the credit policy of commercial banks.

The law passed on May 19, 1992 "On Banks" contains a much more complex and complete regulation of operations of credit institutions. The Bank of Latvia is authorized to issue binding regulations and directives to credit institutions. Unfortunately, this law, too, did not include restricting norms on transactions with businesses linked to the relevant credit institution. It can be said with certainty that "pocket banks" continued to be established and developed. Obviously commercial banks established to service a certain small group of companies are not interested in granting loans to other companies, especially SMEs, which are always considered a high risk group because of insufficient equity. On the other hand, the government lacked funds and desire to support the development of a specific credit policy targeted to SMEs.

Based on the authority granted to the Bank of Latvia, on August 12, 1992 the Board of Directors of the Bank of Latvia passed the resolutions "On Credit Policy" and "On Credit Classification". The first provided that the basic conditions for granting loans are that:

1) the borrower has sufficient asset capital (statute capital or property which may be foreclosed; the borrower must have profitable business operations, as evidenced by financial statements and business plan, audit material, etc.;
2) financially unsafe loans must have good security. However, the Resolution "On Credit Classification" provided the criteria for sufficient loan security (only one of the conditions must be met):
   - government guarantee or securities ensure full credit;
   - another solvent bank's guarantee ensures full credit;
   - credit is secured by a pledge of insured mobile or real property, and has been issued in an amount not exceeding 70% of the market value of this property.

The greatest interest is created by this last condition, which is obviously unfavourable to SMEs. It can be said that the aforesaid BL resolutions denied credit institutions the opportunity to grant loans to many SMEs even on those rare occasions when a credit institution wished to do so. Furthermore, the requirement to insure property increases the cost of the loan.

An important turn in drafting new norms regulating operations of credit institutions was the Law on Credit Institutions passed on October 5, 1995. The law provided restrictions in case of associated companies and amount of transactions with one and the same client – amount of risk transaction with:

- one client (associated group of clients) may not exceed 25% of the credit institution's own capital;
- the total to persons linked with the credit institution may not exceed 15% of the credit institution's own capital;

Involvement of the bank in the basic assets of a company which is not a bank may not exceed 15% of the bank's own capital.

Regarding credit policy, Article 53 provided the following restrictions:

"A credit institution may grant a loan if it is secured by at least one of the following types of security:

1) mobile property (chattels);
2) real property (mortgage);
3) assignment of an insurance policy to the credit institution, with the policy held by the credit institution;
4) guarantee;
5) securities;
6) other security if not in conflict with currently effective laws.

(2) In individual cases a credit institution may grant a loan without the security mentioned in part one of this article; however, the total amount of loans paid out in this manner may not exceed 15% of the credit institution's own capital."

An undoubtedly positive factor was the granting of the right for credit institutions to pay out unsecured loans.

In May 1998 amendments were enacted to the Law on Credit Institutions, deleting Article 53 Thus the legislator revoked norms restricting SME credits.

While high loan rates existed on government bonds, commercial banks directed a considerable part of their funds to the purchase of government bonds. When BL managed to considerably reduce the Bond rates in 1997, commercial banks began to invest their funds in bonds of CIS countries. As a result, considerable funds were tied up in financial operations which gave no support to Latvian companies (except the commercial banks themselves).

Government bonds, being a safe and liquid investment, are obviously more attractive to commercial banks than paying out loans to companies, especially SMEs. The way to reduce the risk rate of loans to SMEs is government guarantees. Unfortunately, the Guarantee Agency established in 1998 has still not started real operations in Latvia.

In some other countries banks are divided into investment and credit banks, depending on the type of investments they practice. At present Latvian banks can be considered to be basically investment banks and, from the viewpoint of crediting SMEs, this is a negative phenomenon. It must be understood that it is not possible to force credit institutions to grant loans to SMEs; this process can only be encouraged indirectly, for example, by regulating the division of investments made by credit institutions (determining the maximum permitted part of bonds in a bank's liabilities). In practice, controlling actual types of investment in foreign countries is at least complicated, and it is not clear whether BL specialists are prepared to undertake this work. It must then be concluded that the government should establish a special credit institution with government capital, which would lend to SMEs. Similar structures are successfully working in other countries, for example,

Table 32 How Local Laws Affect Entrepreneurship

Title of Act	Article	Comment of changes	Effect
LSSR law "On Banks" 02.03.1990		■ Provided basis for operation of commercial banks and their right to grant loans.	+
RL law "On Banks" 19.05.1992		■ Improved the legal basis of credit facilities.	+
Resolution of BL No. 49–6 12.08.1993	1	■ Defined sufficient loans security.	–
Resolution of BL No. 49–7 12.08.1993	3	■ Provided basic conditions for granting loans.	–
Law on Credit Facilities 5.10.1995	53	■ In certain cases unsecured loans could be granted.	+
BL "Regulations for assessing extra-budgetary commitments" 17.01.1996	3	■ Loans security had to exceed the amount of loan and interest one and a half times.	–
Changes to the law on credit facilities 21.05.1998	53	■ Revokes mandatory loans security.	+
Mortgage law 10.09.1998 (as CM Regulations 14.04.1998)	4	■ Provided that mortgages were securities in open circulation;	+
	5	■ Provided for a limited number of credit institutions which may emit pledge notes;	–
	13	■ Provided that the repayment value of pledge notes were not included in the bank's assets.	+

in Canada. It is possible that the Latvian Mortgage and Land Bank, which is at present the only credit institution in Latvia with 100% government capital, could become such a credit institution.

A positive step from the viewpoint of SMEs was the law on mortgage pledge notes passed in 1998. This law provided the opportunity for banks to emit pledge notes, thus attracting credit resources to the financial market which could be used mainly to lend to physical persons and SMEs. Since according to legal norms the repayment value of pledge notes (mortgaged real property) must be kept separate from other assets of the bank, and they may not be foreclosed on to satisfy other demands (including a case of insolvency of the bank), but since credit resources would form mainly from funds of purchasers of the pledge notes rather than the bank itself, the risk of credit institutions in these operations is rather minimal. This, in turn, improves the opportunity for SMEs to take advantage of such services, which under ordinary circumstances would find themselves outside the banks' credit policy. A negative sign is the requirement of the law that only those banks may emit the notes whose own capital is at least Ls 5 million, nor are there any restrictions on operations laid down by the central bank. This requirement considerably narrowed down the number of Latvian credit institutions permitted to emit pledge notes. A restriction on borrowers, especially SMEs, is also the condition that the amount of loans may not exceed 60% of the real property market value of the mortgaged real property, and, in an unstable real property market, such a requirement must be considered unavoidable.

Conclusions and Recommendations

It is desirable that the Latvian Mortgage and Land Bank be made a state-owned credit institution specializing in crediting SMEs or – in a broader sense – a development bank;

To ensure proper operations on the part of the Latvian Guaranty Agency which at present lacks the necessary financial resources;

With a view to developing mortgage lending, land reforms must be speedily completed and restrictions on credit institutions emitting pledge notes must be revoked.

Foreign Trade

After the renewal of the Latvian state on May 4, 1990, the territory of Latvia was still situated within the USSR economic system. Since this system was characterized by a chronic shortage of goods and services and demand outweighed supply under conditions of fixed prices, the Latvian government chose to protect the domestic market with the help of administrative methods. Beginning July 1, 1990 regulation of import and export of goods and services by licences and quotas were introduced. The list of goods requiring export licences included practically all food and light industry products made in Latvia, as well as lumber, building materials and rolled metal. Issuing of licences and determining of export quotas was entrusted to the Ministry of Economy. A legal or physical person was able to receive a yearly, quarterly or once-only licence (for a specific transaction). The recipient of the licence had to submit a report on the use of the licence once a month. Sanctions were laid down, in the case of exporting without a licence, five times the value of the exported goods. Physical persons, leaving Latvia, were permitted to take out food items valued at 20 rubles. It was prohibited to export practically all light industrial production. Since during this period private business in Latvia was just developing (there were only SMEs) and trade operations were considered the simplest way to accumulate starting capital, these restrictions were considered a serious obstacle to SME operations. In the fall of 1990 the Council of Ministers passed a resolution to prohibit banks from making payments on foreign trade by persons who lacked the necessary licences, and introduced administrative penalties in case of violations of customs regulations.

Since the introduced licensing procedures applied only to transactions with companies situated within the territory of the USSR, as well as Lithuania and Estonia, a CM Resolution was passed at the beginning of 1991 to license export and import (to and from other countries). Issuing these licences was entrusted to the Foreign Trade Relations Department. Licences were divided into individual (on transaction), open individual (for a certain volume of production over a year), general (foreign trade associations, Ministries and departments for a period of up to a year), as well as agency licences. In fact this created similar problems for SME transactions with their Western partners. Changes were made to the CM Resolution

No. 40, deleting the list of goods which physical persons were forbidden to take out of the country.

Instead a maximum value of the export goods was set: 60 rubles for food items, 600 rubles for others. It should be noted here that at the beginning of business development it was difficult to separate the SME owner as a physical person and his business operation, thus restrictions applicable to physical persons indirectly affected SMEs. The list of licensed goods was drawn up in a more detailed nomenclature, yet still included practically all goods and raw materials produced in Latvia. In May 1991 a new norm was approved concerning issuing licences for the import of goods and services to the USSR, Lithuania and Estonia, providing that licences for food items will be issued by the Ministry of Agriculture or the Ministry of Trade (Ministry of Agriculture for fish production), for consumer goods – the Ministry of Trade or Material Resources (for some building materials, the Ministry of Economy), fuel and energy resources – the Ministry of Energy. There was division of general (ministries and departments) and individual (for companies exporting a set quantity of production) licences. Physical persons were permitted to export their own agricultural production with a permit issued by the local municipality. This procedure complicated business operations even more, because frequently licences had to be obtained from several institutions for one business transaction. The complicated licensing system affected SME operations especially unfavourably because of their limited human and financial resources. For a small business the time and money spent in obtaining a licence could not be considered insignificant. The previous procedure was retained for export to other countries. In addition, a resolution was passed in May 1991 which prohibited the export of timber exceeding a certain diameter. It should be noted here that by the end of 1991 the fixed price system was almost completely revoked, and as a result it was essentially no longer necessary to protect the domestic market from massive exports with the help of licensing.

At the beginning of 1992 the CM passed a resolution on temporary customs tariffs on forestry products. This resolution introduced export duty on wood and its products, and provided that the licensing procedure did not apply to the export of forestry products. This resolution can be considered the first step toward transition from administrative regulation to customs tariff system. It was important also because at the beginning of the nineties, exports of lumber and timber was an area where SMEs developed rapidly. Regarding other goods, in February 1992, unified licensing regulations were approved for export from Latvia (to any country and any goods) Individual and general licences for agricultural production were issued by the Ministry of Agriculture, fish products by the Ministry of Maritime Affairs, others – by the Ministry of Foreign Trade. Physical persons retained the right to export their own agricultural production with permission of the local municipality. Customs regulations were adopted for physical persons, which forbade export of arms, narcotic or psychotropic substances, pornography, hunting trophies, works of art and cancelled securities without a proper licence.

On June 1, 1992 a CM Resolution came into effect on temporary import and export Customs tariffs, which revoked the licensing system. Restrictions on export of hardwood timber without a licence were retained, as well as the prohibition on importing or exporting or transit of arms, narcotic substances and pornography and export of cultural valuables, which applied to all persons. Although the new regulations, from the viewpoint of SMEs, did not essentially change the situation, the simplified procedures and reduction of the number of institutions issuing licences was a favourable factor. It is also noteworthy to mention a retrogression of administrative interference when the order of the Chairman of the CM on May 19, 1992 forbade the export of any kind of nonferrous metals from Latvia (also by companies holding the appropriate licence). This order was revoked on June 1st; however, it was again adopted in July (again revoked two days later).

After adoption of the law "On Customs Duty (tariffs)" in 1994 (effective December 1, 1994), regulation of foreign trade in Latvia was performed with the help of the customs tariff legislation and basically corresponds to world practice. Although a Consultative Council on Customs Tariffs existed, it should be noted that the opportunities for SMEs to actively influence policies of the legislator in this area was limited. After adoption of the law in January 1995 CM Resolutions 189 and 199 adopted in 1992 became null and void. They were replaced by regulations on determining customs value of goods. It can be assumed that starting with the adoption of these norms, the government stopped active administrative interference in regulating foreign trade.

It should be noted, however, that although a system was introduced to regulate tariffs, certain restric-

Table 33 How Foreign Trade Laws Affect Entrepreneurship

Titles of Act	Article	Contents of amendment	Effect on SME
RLCM Resolution No. 40 (29.06.1990) "On Regulating Import and Export of Goods and Services in the RL"	1	■ Provides that import and export of goods shall be regulated with the help of licences and quotas;	–
	41	■ Provides a list of goods which goods require an export licence from ME;	–
	4.2	■ Provides a list of goods which physical persons may not export from Latvia at all.	–
RLCM Resolution No. 154 (11.10.1990) "On the Procedure for Control of Import and Export of Goods and Services"	2.5	■ Provides that recipients of import/export licences must submit them to a banking institution, otherwise banking institutions are prohibited from making payment regarding foreign trade operations;	–
	6.4	■ Introduces administrative penalties in the event of violations of the above provisions.	–
RLCM Resolution No. 5 (07.01.1991) "On Licensing Export and Import of Goods in RL"	1	■ Confirms the resolution on export and import of goods outside the USSR;	–
	2	■ Orders licensing of import, export and barter transactions, as well as listing goods to be licensed, for the benefit of the Foreign Trade Relations Department.	–
RLCM Resolution No. 8 (10.01.1991) "On Amendments to RLCM Resolution No. 40 of 29.06.1990	1	■ Approves a new, more extensive list of goods which require an export licence;	–
	2	■ Revokes restrictions for physical persons to export certain goods from Latvia, laying down instead a maximum value of the goods to be exported.	+
RLCM Resolution No. 136 (20.05.1991) "On Regulation of Export and Import of Goods and Services in RL"	1	■ Approves new licensing provisions to the effect that for export of goods to the USSR, territory licences will be issued by six ministries, but to other countries by the Foreign Trade Relations Department, also provides that export and import quotas are approved by the CM";	–
	2	■ Provides that permits to physical persons to sell agricultural products produced by themselves are issued by municipalities;	+
	3	■ Provides that physical persons may export goods for personal use to the amount of fifty rubles.	–
RLCM Resolution No. 11 (13.01.1992) "On Procedure for Application of Temporary Export Customs Tariffs on Forestry Products"	1	■ Introduces a system of export customs tariffs on forestry products depending on the stage of dressing;	+
	5	■ Stops the application of CM Resolution No. 5 ("On Export and Import Licensing of Goods") on forestry production;	+
	6	■ Revokes a prohibition effective July 19, 1991 to export timber exceeding a certain diameter.	+
RLCM Resolution No. 40 (04.01.1992) "On Regulation of Production and Goods and Customs Provisions in case of physical persons entering and leaving the Republic of Latvia"	1–3	■ Introduces a single licensing procedure for export of goods and production, providing that licences are issued by the Ministry of Foreign Trade, Ministry of Agriculture and Ministry of Maritimes Affairs;	+
	6–7	■ Approves customs provisions for physical persons entering and leaving Latvia, listing certain items and goods whose import or export is prohibited except when special permission has been obtained.	+
RLCM Resolution No. 198 (28.05.1992) "On Temporary Export Customs Tariffs on Goods"	1	■ Approves temporary export Customs tariffs;	+
	6	■ Provides a list of certain items and goods which may not be exported by legal persons without a special permit;	–
	8	■ Revokes provisions for licensing export of goods.	+
RLCM Resolution No. 199 (28.05.1992) "On Temporary Import Tariffs on Goods and Customs Provisions entering and leaving RL"	1	■ Confirms temporary import tariffs on goods;	
	5–6	■ Confirms Customs provisions for physical and legal persons entering and leaving RL.	+

Title of Act	Clause	Content of changes	Effect
RLCM Resolution No. 248 (20.06.1996) "On Government Monopoly on Alcohol and alcoholic beverages"	38	■ Requires that import of alcohol and alcoholic beverages require a license;	–
	44	■ Introduces a set amount of basic capital and monthly turnover a condition for receiving a licence.	–
RLCM Resolution No. 348 (07.10.1997) Regulations for Licensing Certain Types of Business	6.13	■ Provides that importing of fuel, alcoholic beverages, tobacco products, grain and sugar shall require a license.	–
RLCM Resolution No. 432 (23.12.1997) Regulations on Fuel Circulation	7	■ Provides that a licence is required for the import of fuel;	–
	31	■ Introduces a set amount of basic capital and volume of annual import as conditions for receiving a licence.	–
		Total "+"	9
		Total "–"	16
		Total "+ –" or "– +"	0

tions of trade transactions by licensing were retained. Although no quotas exist, a licence was needed by any company engaged in importing sugar or grain (the licence was issued by the Ministry of Agriculture), as well as fuel, alcohol and tobacco products (the licence was issued by the Ministry of Finance). Licensing regulations for the trade of alcoholic beverages and fuel provide for the need of a certain amount of basic capital and turnover as conditions precedent to receive a licence (to import fuel – Ls 20,000 basic capital and at least a volume of 5,000 tons annually; to import alcohol – Ls 15,000 basic capital and a monthly turnover of between Ls 5,000 and Ls 100,000, depending on the type of beverage). These regulations may be considered a direct restriction of SME operations, directed at forcing SMEs from the market. Receiving import licences for sugar and grain are not linked to discriminating restrictions regarding SMEs, and the Cabinet of Ministers lays down a certain quantity of import grain which may be imported free of Customs duty. There are no other types of restrictions outside Customs duty in the area of foreign trade, and generally speaking, the situation may be considered favourable to business, including SMEs.

Conclusions and Recommendations

Outside Customs duties, restrictions in foreign trade are minimal and do not cause significant problems for SME operations. In order to ensure equal conditions for SME operations, revoking norms which restrict SME operations regarding trade in fuel and alcoholic beverages (also import) should be considered.

The most important act of Latvian legislation is the Labour Code, which is actually the "Latvian SSR Code of Labour Laws" enacted in 1972 and repeatedly corrected and supplemented. The first corrections were made to it as early as June 1990 pursuant to the "Convention on Reducing Working Hours" (1945). In analyzing these corrections as well as development of the future legislative acts, it is obvious that gradually the workers' legal protection was improved, especially in matters regarding regulation of minors' and women's labour and holidays, as well as the procedure for starting and ending the legal relations of labour. Every developed country strengthens protection of the rights of its labour force in its legislation within certain limits, thus it would not be correct to criticize the process as a whole, although its negative impact on business cannot be denied, especially in SME development. It is important to ensure the predictability of the process and opportunities for the practical application of rights of the parties.

Labour Legislation

In order to keep its place in the market under conditions of competition, a small business must be flexible, able to react quickly to outside factors. Changes in the number of employees, wages/salaries and working hours is one of the possible reactions of a businessman. The legal relations of employment are regulated in detail in normative acts.

When considering new norms, as a rule labour relations are analyzed in large companies, forgetting the specifics of small business. For example, increase

in redundancy pay – for a large company payment of redundancy benefits can significantly affect the company's financial indicators only in the case of massive lay-offs, but in the case of SMEs, and especially in micro businesses, the proportion of each employee to the whole company is much greater, and high redundancy benefits may cause serious losses. As a result the owner may attempt to circumvent labour legislation when signing employment contracts or hiring employees without written agreements. As a result thereof, the government loses tax revenue. In establishing and developing the legal basis of labour relations, the legislator must be aware of how the new norms will affect SMEs and whether they will limit their competitiveness and development.

For example, the changes made to Article 78 of the LSSR Code of Labour Laws in June 1990 provided rights for women who have three or more children under the age of sixteen years or a disabled child to receive additional leave of 3 days. Changes made in December 1990 revoked this right, but in June 1991 it was re-instated in its previous wording. The original wording of the LSSR Code of Labour Laws required employees to give the employer two months notice before leaving. In 1992 this period was reduced to two weeks, but in 1992 was increased to one month. Amounts of redundancy pay, too, were changed several times. It must be noted that legislative inconsistency causes unnecessary tension in the labour market and makes it difficult for companies to plan ahead – a business is not certain of its labour costs over a longer period of time. In order to avoid the negative effect of unplanned expenses, changes in the law which increase company costs must be given a longer period of introduction. As we pointed out before, SMEs may suffer more as a result of changes to legislative acts than large companies.

A serious problem is the actual implementation of rights of the parties. Incomplete norms lacking a clear mechanism for application provide only an illusion of protection. Is the employer protected against losses caused by an employee's leaving? It is officially provided that the employee must warn the employer in writing a month before leaving, but in reality it is not possible to ensure that the employee will continue to perform his/her duties properly during the last month. Thus an employer is forced to let the employee go before the aforesaid period "by mutual agreement" and quickly find another employee. For SMEs even a short time loss of an employee may cause serious consequences.

When discharging an employee, the employer usually has no way to avoid performing his duties (paying wages/salary), in addition he must pay a redundancy benefit. It must be concluded then, that a true equality of the parties in this matter has not been ensured.

According to existing legislation, an employee is hired by signing a written employment contract. The employment contract is made in duplicate, one is kept by the employer, the other by the employee. An employer may enter into an employment contract with citizens and permanent residents of the Republic of Latvia. According to the employment contract so signed, the employer may issue orders binding to its services.

Although according to the Civil Law, a contract may also be verbal, the Labour Code provides that employment contracts must be in writing. The employment contract is a written agreement between the employee and the employer, pursuant to which the employee agrees to perform certain work, observes the internal company regulations or the employer's orders, and the employer agrees to provide payment for the work and working conditions as provided in legislative acts, the collective labour agreement and by mutual agreement.

An employee may enter into an employment contract with several employers, provided they do not conflict with the law, the collective labour agreement, and agreement of the parties.

An employment contract may be made:

1) for an indefinite period;
2) for a definite term;
3) for the period of performance of certain work.

Upon request of the employee, an employment contract made for an indefinite period may be a contract made for a definite term, if the agreement in question is already the third agreement for a definite term made by the employee with one and the same employer, but only if during the period of time from the day the first contract for a definite term was made, until the day the third agreement is made, legal relations between the parties have not been interrupted for more than thirty consecutive days.

When entering into an employment contract, a trial period may be set to determine whether the employee is suitable for the work entrusted to him/her. The trial period may not exceed three months.

If the trial period has expired and the employee continues to work, it must then be assumed that

Table 34 Changes to Labour Legislation and Their Effect on Business

Title of Act	Content of changes	Effect on SME
The law "On Changes and Supplements to LSSR Code of Labour Laws" 27.06.1990	■ Reduces working hours to forty a week;	–
	■ Increases period of additional leave for women caring for children;	–
	■ Permits reduction of the length of annual holiday by days absent from work.	+
The law "On Changes and Supplements to LSSR Code of Labour Laws" 10.12.1990	■ Revoked the right of mothers of large families to additional leave.	+
The law "On Changes and Supplements to Articles 173 and 176 of the LSSR Code of Labour Laws" 26.02.1991	■ Supplements rights of women to maternity leave.	–
The law "On Collective Labour Contracts" 26.03.1991	■ Provides that the collective labour agreement is an agreement between the employer and employees to be signed on recommendation of authorized representatives of a trade union or the employees concerning issues of remuneration, social guarantees, labour safety, continued education and environmental protection;	–
	■ Provides for employers' responsibility to inform employees of the company's financial situation;	–
	■ Provides that disputes concerning signing of the collective contract, changes to or performance of it shall be reviewed by a conciliation commission. In the event it cannot reach a solution, the parties may go to court or arbitration.	+
The law "On Changes and Supplements to LSSR Code of Labour Laws" 07.05.1991	■ Renews rights of mothers of large families to additional leave.	–
The law "On Changes and Supplements to LSSR Code of Labour Laws" 17.03.1992	■ Provides that the collective labour agreement may be made also for an indefinite period; commitments included in the agreement may not apply to all employees;	+
	■ Provides that the labour agreement must be made in writing and may be made for an indefinite period;	+
	■ Entitles employers to set a trial period unilaterally;	+
	■ Restricts the type of employees for whom no trial period may be set;	–
	■ Reduces the minimum term of notice by employee to leave employment;	+
	■ Entitles employers to keep employees who have reached retirement age;	–
	■ Increases the minimum term of warning employers must give employees of closing down, bankruptcy or staff reduction;	–
	■ Increases the circle of employees enjoying additional protection against discharge;	–
	■ Increases redundancy pay in certain cases;	+
	■ Revokes standartization of working hours;	–
	■ Increases minimum overtime pay;	+
	■ Increases social guarantees for parents;	–
	■ Reduces privileges for employees attending an educational facility;	+
	■ Provides types of disciplinary punishment which employers may use, considering discharge to be disciplinary punishment;	–
	■ Provides that the chief institution for hearing disputes is the Labour Dispute Commission, whose decisions may be appealed in court.	+
Founding Law "On Labour Dispute Commissions" 02.04.1992 (adopted by the Presidium of the Supreme Council).	■ Provides principles for establishing and operations of Labour Dispute Commissions;	–
	■ Provides that decisions of Labour Dispute Commissions have the power of a document of execution.	–

Title of Act	Content of changes	Effect
	■ Reduces the minimum period for employers to warn employees of essential changes in the labour agreement and staff reduction;	+
	■ Increases the minimum term of notice employees must give the employer of their intention to leave.	+
The law "On Changes and Supplements to the Latvian Code of Labour Laws" 06.04.1993	■ Provides that a Labour Inspectorate is an administrative institution monitoring observance of labour and labour protection legislation, as well as observance of signing labour agreements and their performance.	–
Law "On Renewal of the Law of RL of 28.04.1939 "On Labour Inspectorates"" 04.05.1993	■ Requires employers to ensure observance of norms of hygiene, and equipment safety and provide training for employees in matters of labour safety technologies;	–
	■ Requires employers to ensure at their cost medical inspections, protective clothing and diet, shorter working hours and additional leave for employees performing heavy or hazardous work;	–
	■ Provides that a specialist in labour protection matters be designated, and in cases where the number of employees exceeds fifty, establish labour protection councils.	–
Law "On Labour Protection" 04.05.1993	■ Increases redundancy pay if the labour agreement is breached because of its non–compliance with requirements of law.	–
The law "On Changes and Supplements to LSSR Code of Labour Laws" 01.06.1993	■ Reduces redundancy pay in individual cases.	+
Law "On Changes and Supplements to LSSR Code of Labour Laws" 15.06.1994	■ Provides equal rights to employees regardless of their age.	–
Law "On Changes and Supplements to LSSR Code of Labour Laws" 14.03.1996	■ Provides a mechanism for changing term labour contracts into indefinite term contracts.	–
Law on Strikes 23.04.1998	■ Provides a procedure for pre-strike negotiations and adopting a decision to strike (three quarters of all employees must attend the meeting; the decision is adopted if three quarters of voters are in favour);	+
	■ Forbids strikers to block entry to the business and that no wages are paid during the strike;	+
	■ Provides opportunity for employers to ask for court injunction against the strikers;	+
	■ Determines the minimum of first necessity functions to be ensured in case of a strike;	+
	■ forbids hiring of scabs.	–
	Total "+"	18
	Total "–"	23
	Total "+ –" or "– +"	0

he/she has passed the test and future discharge in this case is permitted only on general provisions. But if the results of the trial period are unsatisfactory, the employer may discharge the employee without paying a redundancy benefit. In fact, this norm protects interests of the employer in the area of selection of staff and is important for SMEs where hiring untried personnel may cause disorganization of operations. The employee may appeal discharge under these conditions in court.

Reasons for discharge are:

1. mutual agreement of the parties;
2. in the event that the term of the contract has expired, except in cases when labour relations continue and neither party has asked to cancel them;
3. conscription (volunteering) of the employee for the compulsory services, service with institutions of the interior, National Armed Forces or the civil service;
4. the employee's resignation;
5. termination of an employment contract on the initiative of the employer or on request of institutions which are not parties to the

employment contract (employees' professional organizations and territorial trade unions, employers' confederation, State Control, State Labour Inspectorate and the State Language Centre, the employer in state and municipal enterprises, institutions and organizations must discharge the manager (deputy) if he violates labour legislative acts, deliberately delays signing of a collective labour contract or fails to honour commitments under a collective labour contract;

6. transfer of an employee to another company, institution or organization with his/her consent, or moving to an elected office;
7. the employee's refusal to transfer to another job, to another region with the employer, refusal to continue working under significant changes to the employment contract or failing re-election to the same office (also in case of a bid);
8. court judgement coming into legal effect, finding the employee guilty and sentenced (except in the case of a suspended sentence) to a prison term or other punishment, thus being unable to continue his/her work;
9. violations of the laws of the Republic of Latvia when entering into the employment contract or non-compliance of the contract with requirements of the law;
10. death of the employee.

An employment contract does not cease because the change of the owner of the business. If the business merges, is divided or is amalgamated, the employment contract may be cancelled on the initiative of the employer only if staff is reduced.

The employee may leave employment by serving the employer with one month's written notice. The notice period does not include periods of temporary disability.

In the event the employee and employer mutually agree, the employee may leave before expiry of the said period.

The employer may discharge an employee in the case of an employment contract made for an indefinite period or before expiry of a contract in case an employment contract made for a definite term in the following cases only:

1. if the business is closed down;
2. if staff is reduced;
3. if it is found that the employee has insufficient skills or he/she is unable to continue the work because of health problems;
4. if the employee fails without good reason to perform the duties assigned to him/her by the employment contract or internal regulations;
5. if an employee who is directly responsible for monetary or merchandise values has acted illegally and has lost the employer's trust;
6. if the employee fails to report for work for four consecutive months because of temporary disability other than maternity or birthing leave, unless the law provides that the job be saved for a longer period of time in certain cases of sickness. Employees injured in an industrial accident or who have contracted an industrial disease and have become disabled as a result, keep their job until able to work again or their disability is affirmed;
7. if an employee is re-instated who performed the work previously;
8. if the employee is found at work under the influence of alcohol, narcotics or other toxic substances;
9. if the employer's property has been stolen (also in small quantities) and a court judgement come into legal effect or a decision of an institution authorized to hear the case, has confirmed it.

If in the event the business is closed down and staff is reduced, it is found that an employee lacks sufficient skills for his/her job or is unable to continue his/her work because of health problems, or fails to report for work for more than four consecutive months because of a temporary disability, and if an employee is re-instated who had performed the work previously, when terminating the employee's employment agreement, the employee is personally notified in writing of the expected termination not later than a month in advance. The contradiction that occurs if an employee is re-instated who had performed the aforesaid work previously must be pointed out. As a rule such re-instatement occurs by court order, which, according to procedural legislation, must be effected without delay. However, the employee who must now be discharged, must be notified a month in advance. In fact such a discharge by court order cannot be effected and the employer must, at least for a time, pay wages to both these employees. Because of their limited financial resources, this problem is especially acute for SMEs.

The legal contradiction regarding discharge also occurs between norms of the Labour Code which regulates the procedure for terminating labour contracts

and cases, and legal acts concerning business operations, which provide that management staff (members of Board of Directors, Council), may be terminated at any time. Since these people receive their salaries pursuant to an employment contract, the question of procedure for their termination arises, which again is especially acute from the viewpoint of owners of SMEs in cases when a disagreement has arisen between business managers concerning strategic issues of business operations.

In all the above mentioned cases, except the case when an employee is discharged because he/she fails to report for work for more than four consecutive months because of a temporary disability, the employee must be paid a redundancy benefit of at least one month average salary or an amount provided in the collective labour agreement or the employment contract, or by agreement of the parties. The redundancy benefit must also be paid if an employee is discharged because of conscription (volunteering) for the compulsory state service, service with the interior institutions, National Armed Forces or the civil service or when an employee refuses to be transferred to other duties in another region with the employer, refuses to continue his/her work because of significant changes made in the provisions of the employment contract, or if he/she is not re-elected to the office for another term (also on a bid).

When the employment contract is terminated because of violations of the laws of the Republic of Latvia in making the contract, or if the employment contract does not comply with requirements of legislative acts on labour protection, a redundancy benefit must be paid of not less than six months average earnings. The requirement to pay a redundancy benefit, as well as the limited opportunities for discharging an employee on the initiative of the employer, certainly protects the interests of the employees, but considerably limits the SME ability to manoeuvre in the labour market and carry out rapid changes in their operations.

The legislation provides for a forty-hour work week and a condition that in the case of employees engaged in performing heavy work and work under hazardous conditions, as well as minors, the length of their work week may not exceed thirty-five hours. For persons under sixteen years of age, the maximum length of their working week is twenty four hours. Overtime is permitted only with the consent of the employee and not more than one hundred and twenty hours a year; furthermore, it is not permitted for more than four hours on two consecutive days. Also, minors and pregnant women, and women with a child under three years of age may not be employed in night work. Remuneration for night work must be paid at time-and-a-half, but for overtime, work on holidays and days off, double-time. Employees may be asked to work on their days off only in emergency situations and with the consent of trade unions. This norm does not apply to businesses and institutions working on a twenty four hour (uninterrupted) basis. The vacation time provided by legislation is four calendar weeks (a month in the case of minors). Additional leave must be granted to employees performing heavy or hazardous work, as well as women who have at least three children under the age of sixteen years.

These norms, which ensure normal protection of employees' interests, in reality often lead to attempts on the part of SMEs to avoid hiring minors and women who have young children, because from the viewpoint of SMEs, such relief, too, is not an insignificant factor.

Although since 1991 the law provides the choice of signing collective labour agreements, these are very rare in reality. In part, this is due to the decline of trade unions as protectors of collective organizations and of interests of employees after the collapse of the Soviet regime. For the same reason there is little practical meaning in the norm prohibiting the discharge of an employee on the initiative of the employer without the consent of trade unions (except in the case of closing businesses, unsatisfactory results of the trial period, reporting for work under the influence or theft of employer's property, as well as discharging employees working for several employers). In most businesses, especially SMEs, there are no trade unions. In reality, requirements of the law are rarely complied with regarding the presence of a specialist in labour protection (in cases of more than fifty employees – a structural unit) within the business. In essence this is a formal approach on the part of the legislator, because in order to observe labour safety there is no need for a specialist or a structural unit, but observance of this formal requirement requires additional costs on the part of the employer, which again is not an insignificant factor for SMEs.

Also, at present legal norms providing for a labour dispute commission as the first instance in resolving labour disputes (except discharge on the initiative of the employer and illegal refusal to hire), are not applied in practice. The founding law of labour dispute commissions provides that it be established at

every place of employment employing at least fifteen people (in the case of most SMEs), reviewing cases within fifteen days of receiving a complaint, and a choice of appealing the decision of the commission in court within ten days. The meeting for electing the commission from among representatives of the employer and employees must be called by the employer, which in reality is simply ignored. Furthermore, the legal status of the founding law is doubtful, because it contains procedural norms for addressing civil rights disputes, but it is not approved by the legislator, only the Presidium of the Supreme Council. Legal acts, among them the Code of Civil Procedures, does not provide for the existence of such a founding law or authority on the part of the Presidium of the Supreme Council to adopt it. Since such labour dispute commissions are seldom established, and in reality, none exists at a SME, all labour disputes go directly to court. Here one should mention the norm which protects the interests of the employer, providing that for a month after violation of his rights, the employee may ask the court for help (the general statutory limitation is ten years). Thus cases are prevented when a discharged employee may file a claim to be re-instated in his/her job, for example, a year after the discharge, even asking for payment of wages for the time of absence. For SMEs such cases would result in unreasonably heavy financial consequences for the employer.

On the other hand, the strict restrictions prohibiting the employer from terminating indefinite period agreements are circumvented by referring to the norm of the Labour Code, which entitles an employer to introduce unilaterally significant changes in the employment contract concerning the amount of compensation, working conditions, relief, title of position and categories. In case the employee does not consent to the changes, he/she may be terminated after one month, paying a redundancy benefit for another month. Although application of this procedure takes time and money, it does increase the opportunities for an employer to carry out rapid changes in his business. In practice, SMEs are most often the party which takes advantage of this norm to terminate employment contracts of employees who need to be discharged. Employees violating work procedures and discipline may be punished by the following:

a) reproof;
b) reprimand;
c) discharge, if the disciplinary measure is applied in case of non-observance of work procedures or employment contract, reporting for work under the influence or theft of employer's property, confirmed by way of a court judgement coming into legal effect).

Disciplinary action may be applied within a month of the moment a violation is found, but not later than six months after the violation occurred. The employee may appeal a decision to apply disciplinary measures to the labour dispute commission or the court (if there is no labour dispute commission). It should be noted that the legislation does not provide that an employer is entitled to discharge an employee in the case of a serious disciplinary violation (even if criminal charges are laid in the case). This can only be done upon demand by law enforcement agencies. This provision, too, affects mostly interests of SMEs for which the presence or absence of even one employee is important.

Regarding the procedure for addressing collective labour disputes, the Strike Law passed in 1998 must be noted. This law provides procedures for negotiations prior to a strike and whether an employer may ask for a court injunction in order to consider a strike illegal. The law provides that in the event a strike is called, employees must be ensured of a minimum of vital services in order that the business retains the ability to recommence operations after the end of the strike. The law prohibits hiring of scabs, but also provides that strikers may not block entry to the business or receive pay for the period of the strike. From the viewpoint of SMEs, the law can be assessed positively, because it provides for a procedure for resolving the dispute that is relatively favourable to the employer and protects from arbitrary actions on the part of employees.

Conclusions and Recommendations

1. The labour legislation as a whole provides a broad scope of guarantees for the employee, thus reducing the ability of SMEs to manoeuvre in the labour market.
2. It would be desirable to delete norms of a formal nature only or which have no practical application. Considering the immense changes in the economy, a new codification of norms of labour rights should be considered.
3. When determining relations between employer and employee, the autonomy of both parties should be increased, thus ensuring the true equality between SMEs and employees.

Environmental Protection

Following the renewal of the Latvian State on May 4, 1990, drafting of legislation in the area of environmental protection began with the adoption of the law "On the RL Environmental Protection Committee". The aforesaid law provided that an institution be established which would draw up a national policy and monitor it at the same time. In order to emphasize the priority of environmental protection, the legislator subjected the committee directly to the Parliament, thus taking it away from the joint structure of executive power. From a practical viewpoint, the broad authority of this institution including such understandable rights as suspending or terminating operations of a business violating environmental protection normatives, as well as such questionable rights as, for example, the right to stop any kind of a transport vehicle or the right to recommend that a bank suspend financing of specific projects, could be viewed as a negative factor. From the viewpoint of business development (for all practical purposes, at the beginning of the nineties only SMEs were operating in Latvia), such rights to interfere in the area of private rights could be considered negatively. Furthermore, the law did in fact provide a procedure for applying the EPC authority.

In the fall of 1990 the law "On National Ecological Expertise" was passed. This law provided that a positive opinion of the ecological expertise is a condition precedent for beginning projects of business operations, and also provided that ecological expertise be carried out by the Environmental Protection Committee. The law provided that it is the responsibility of the relevant planner to apply to the EPC prior to start of planning, which then, if necessary, provides an ecological task within a month. But the ecological expertise itself must be carried out within three months. From the viewpoint of business, especially SME, the discrepancy of the law was the unspecified objects of the ecological expertise (for example, new technologies or materials). Essentially, decision about such issues was left to the EPC itself. Since preparation of the necessary documents and information requires in all cases time and money, the procedure slowed down business operations, especially in the area of manufacturing and construction. The law formed an administrative barrier to business, affecting especially SMEs which had to take into account unplanned costs and a subjective attitude on the part of the EPC.

The law "On Natural Resources Tax", passed at the end of 1990, provided that exploitation of natural resources (obtaining usable minerals and emission of pollution) are taxable operations. Not denying the necessity to compensate for exploitation of environmental resources, it must be said that from the standpoint of business development, any tax is a negative factor. Since, during the period in question, business in Latvia was at the development stage, many SMEs considered this tax an additional financial burden to be faced in the areas of manufacture, processing and construction. It should be noted that in 1995 a new law was passed concerning this tax, which provided that a tax be levied on packaging materials and granted tax administration rights to environmental protection institutions, namely the right to apply radical financial sanctions. These changes slowed down private operations and limited opportunities for SMEs to develop.

The next step in the development of environmental protection legislation was the adoption of a blanket law in August 1991, when the law "On Environmental Protection" was enacted. The law did not contain norms directly affecting business or SMEs. It defined a number of meanings and terms, laid down the main course of a national policy and division of authority between various government institutions, defined the rights and obligations of officials and set out the different types of responsibilities (administrative, material, disciplinary, criminal) concerning violation of environmental protection legislation. It should also be noted that in May 1997 this law was amended, defining a number of norms (for example, pursuant to the recent re-organization of government institutions, the functions of the Environmental Protection Committee had been taken over by the Ministry of Environmental Protection and Regional Development). The law incorporated a recommendation to the Cabinet of Ministers to determine the location of waste dumps, procedure for ecological certification, and a list of materials, raw materials and processes requiring certification.

At the end of 1991 a law was passed "On the Procedure to Suspend Operations of Businesses, Institutions and Organizations". The law provided that in the event of violation of normatives of environmental protection, a business could be closed or operations suspended. A procedure was provided for the rights of officials of the Environmental Inspectorate,

already cited in earlier legal acts, to suspend business operations. The law provided that an official of the Environmental Inspectorate must warn the business prior to suspending its operations. A two-month warning period was laid down. If construction or reconstruction was required to prevent the violation, a six-month period was to be given, but if capital construction was needed – two years. Immediate suspension of operations without a warning was permitted only in cases of serious danger (if destruction of natural resources had started or human life was threatened). Although the right of any official to single-handedly interfere in business operations must be viewed negatively; The positive input of this law was the definition of procedures and reduction of arbitrary actions on the part of the administration. From the viewpoint of SMEs, the situation became more predictable which, in turn, improved their ability to plan their operations and estimate costs of environmental protection projects.

In 1993 a law was adopted, "On Specially Protected Territories of Nature". Protected territories were divided into reserves, national parks, biosphere reserves, nature parks, nature monuments, restricted areas and protected landscape areas. The territories of the first three categories were established by passing a special law, the others by resolution of the Cabinet of Ministers. The law provided that restrictions be placed on visiting and business operations in accordance with the provisions for protection and use of each territory, furthermore, reserves and national parks may include zones where any kind of business operations are prohibited. From the viewpoint of business, the authority of the Ministry of Environmental Protection and Regional Development to determine the list of protected territories where land may not be privatized, is viewed as a significant restriction. It must also be taken into account that this legislative norm was adopted in 1993, namely a year after many SMEs had started various operations on such land since 1990 (for example, country tourism projects), assuming that they will be able to privatize the land allocated to them. The justification of such restrictions may be questioned, because the ability to ensure environmental protection measures does not really depend on the form of ownership. Also, the norm incorporated in the law granting the government first right of refusal on any piece of land within the territories of specially protected areas, must be considered unjustified, useless, obstructing business operations and negatively affecting the interests of business, and thus SMEs. A positive factor is the norm incorporated in the law providing that compensation be paid to the owner or user of land for restriction of business operations, which included waiving of taxes. It should be noted here that there are problems which obstruct application of this norm.

At the end of 1998 a law was passed "On Assessing Impact on the Environment", which replaced the outdated law "On National Ecological Expertise". This law listed operations which required that application be made for assessment of the impact such operations would have on the environment (for example, extensive industrial manufacture, agricultural objects or transport). In such cases, the person wishing to implement such operations must approach the appropriate government institution performing assessment if it considers it necessary. In other cases, if the planned operations may affect the environment, the person must apply to the regional environmental service. The Regional Environmental Service carries out the initial assessment of the project and depending on the results of such assessment either considers it necessary to carry out a full assessment of the impact on the environment or issues technical provisions for the implementation of the project.

In cases where an assessment of the impact on the environment is required, the applicant prepares all necessary information, which is then submitted to the institution performing the assessment. The municipality of the territory where operations are planned is also advised of the planned project. Furthermore, it is the duty of the applicant to pay all costs of the assessment and publish information on the planned project in the media. From the viewpoint of SMEs the fact that all costs are paid by the applicant must be considered negatively. Besides, a number of persons (the institution performing the assessment, the relevant municipality, regional environmental service, at least ten physical persons) may initiate a public discussion of the project. Based on the instructions of the institution performing the assessment, the applicant prepares a working report listing all measures for reducing the impact on the environment. Following review of the working report, the competent institution may recommend corrections in it, pursuant to which the final report is prepared. The law provides that even if the final report is accepted, the municipality or the government institution whose approval is required to implement the project, may give a negative answer. Thus this law, which provides a quite detailed assessment proce-

Table 35 Changes in Environmental Protection Legislation and Their Effect on Business

Title of Act	Clause	Contents of changes	Effect
Law "On RL Environmental Protection Committee (20.06.1990)	2, .3	■ Provides that the RL Environmental Protection Committee is an institution implementing and monitoring national policy in the area of environmental protection and is answerable directly to the Parliament;	+
	6	■ Provides broad authority to officials of the RLEPC when carrying out their duties and projects.	–
Law "On National Ecological Expertise" (09.10.1990)	4	■ Provides that national ecological expertise is a necessary condition to planning the economy;	+
	7	■ Defines objects of ecological expertise;	+
	12	■ Defines rights of institutions which provide ecological expertise.	
Law "On Natural Resources Tax" (12.12.1990)	3	■ Provides that the exploitation of natural resources and emission of pollution into the environment are taxable operations.	–
Law "On Environmental Protection" (06.08.1991)	7–10	■ Defines state and municipal competence in the area of environmental protection;	+
	13	■ Provides a choice of requesting assessment of the impact of business and other operations on the environment;	+
	33	■ Provides that specially protected territories may be set aside;	+
	44	■ Defines the basic principles of operations of the National Environmental Inspectorate.	+
Law "On the Procedure to suspend operations of businesses, institutions and organizations" (11.12.1991)	1	■ Provides for rights of officials of the Environmental Inspectorate to order suspension of business operations and to issue a warning of deadlines prior to issuing such order;	–
	8	■ Provides that in especially dangerous situations such an order may be issued without warning.	–
Law "On Specially Protected Territories of Nature" (02.03.1993)	13	■ Provides the procedure for establishing protected natural areas;	+
	3–6.	■ Provides that business operations may be restricted in protected natural areas;	–
	33	■ Provides that privatization of land may be restricted in protected natural areas;	–
	29	■ Provides that compensation may be paid in cases of restriction of business operations.	+
Law "On Natural Resources Tax" (14.09.1995)	4	■ Provides that a tax may be levied on packaging;	–
	18	■ Grants tax administration rights to the Ministry of Environmental Protection and Regional Development.	–
Law "On Assessing Impact on the Environment" (14.10.1998)	5	■ Provides that such assessment is paid for by the initiator, namely the person who wishes to carry out certain business operations;	–
	7	■ Defines activities which are compulsory when assessing the impact on environment;	+
	8	■ Provides that it is necessary to report to the regional environmental service any activity which may have significant impact on the environment;	–
	15	■ Defines a broad scope of subjects entitled to request public discussion of a project;	–
	16–20	■ Provides a procedure for assessing impact on environment;	+
	22	■ Provides that the final decision to renew or not renew operations is made by the municipality or a Government institution pursuant to the assessment document.	–
Law "On Household Waste" (15.10.1998)	10	■ Provides that all persons engaged in the area of household waste must register;	–
	14, Part 1	■ Provides that the decision to establish waste dumps and the charge for waste management is made by the local municipality.	–
		Total "+"	11
		Total "–"	14
		Total "+ –" or "– +"	0

dure, does not protect the interests of the business because, although time and money have been spent. The chance remains that approval could be refused even in the absence of formal objections on the part of environmental protection institutions. Such a situation is explicitly unfavourable to SMEs, especially because of their limited financial resources, they are unable to risk preparing manufacturing projects which may not be accepted by the relevant government or municipal institution.

Finally, in the fall of 1998 a law was passed "On Household Waste", which defined government and municipal authority regarding management issues of household waste. The law provides that the Cabinet of Ministers lays down the procedure for classification, processing of waste and establishing waste dumps. On the other hand, decisions on establishing such dumps is within the jurisdiction of municipalities. From the viewpoint of SMEs, this law contains two unfavourable provisions. The first of these provides for mandatory registration with the regional environmental service of all physical and legal persons engaged in waste management, which from the viewpoint of a business, is a superfluous administrative procedure, because it provides no specific rights or obligations. The second provides that municipalities determine payment for waste management. This norm in fact provides an opportunity for the municipality in question to regulate business operations in its territory. There is a chance that a decision of the municipality on tariffs may be economically unjustified and unacceptable to the business, and also, the law does not provide a mechanism for disputing such a decision.

Conclusions and Recommendations

Authority of environmental protection and tax administration institutions should be defined regarding exploitation of natural resources.

The possibility should be considered to authorize environmental protection institutions (rather than municipalities) to make the final decision on permitting or refusing to permit operations affecting the environment.

In certain cases, it is desirable that consideration be given to provide government or municipal support to SMEs in performing or paying for assessment of impact on the environment.

Public Procurement

Development of Latvian legislation in the area of legal regulation of public procurement after renewal of Latvian independence on May 4, 1990, began with the Resolution passed by the Council of Ministers on November 26, 1990 "On Work and Supplies for Government Needs".

At the time, while a state-regulated economy still existed, this resolution was considered a step in the transition from administrative methods in regulating production to market relations. The resolution provided that the content and scope of public procurement are determined by the Council of Ministers, based on recommendations of Ministries responsible for the relevant sectors of economy (energy, agriculture, transport, trade, fisheries etc.) and municipalities. It was required that public procurement apply to work and supplies paid for from the budget, as well as supply of goods and services to ensure minimum consumption of residents of the country, without providing a detailed explanation of the latter. The resolution did not provide for organization of mandatory tenders or auctions; it was merely stated that such orders were to be performed on contract basis, signed within seven days of receipt of the notice that the order had been received.

It was also provided that any physical or legal person could undertake to provide work and supplies, including foreign nationals. From the viewpoint of SMEs, this legal act can be considered positively, because it provided for equality of ownership forms in obtaining public procurement. At the beginning of development of market relations, this fact may be considered to be an important guarantee to prevent discrimination of new businesses. A negative factor is the fact that tenders or auctions were not a condition precedent to obtain the order. Thus, not competition among bidders but various subjective factors could influence the choice of supplier. Under conditions when the previous experience of government structures was linked solely to state-owned enterprises, private businesses, whose operations were at the beginning stage and all of which belonged to the SME category, found themselves in an unfavourable situation. A positive factor is the opportunity provided in the resolution that the contract made between the client and the supplier should provide for tax relief,

provision of energy resources, namely certain advantages for suppliers of work or supplies. From the viewpoint of SMEs, government support in the tax or credit area can only be deemed a positive factor, however, because of the difficult economic/financial situation of the country, this norm was practically never applied in practice.

On September 26, 1991 CM Resolution No. 250 was passed. This was new resolution on work and supplies for government needs, which replaced previous norms from November 26, 1990. According to this resolution, public procurement could include work and supplies paid for from the budget, supplies to other countries pursuant to interstate agreements, and other work and supplies (without defining them). It was provided that when granting an order, it was necessary to approve terms of the work or supply performance, stating information describing objects of the order, place and deadline for delivery, procedure for quality control, acceptance and payment. The resolution extended the scope of relief for the supplier of the public procurement, providing that it may include tax relief, certain preferences in obtaining credit, as well as access to government resources of raw materials and energy, preference in obtaining foreign trade licences, and opportunities to receive advance payment for supplies. From the viewpoint of SME operations, such government support could only be termed positive; however, it must be repeatedly noted that the aforesaid legal norms were not applied in practice. For example, tax relief, as provided by the CM resolution, was not provided in the relevant tax laws.

The resolution provided that the chief way of granting orders was a publicly announced auction or tender (verbal or written). The resolution stated that auction would mean granting the order to a person who agrees to complete it at the lowest price, but tender would mean review of bids to choose the best suited candidates. The resolution did not provide that orders be granted without an auction or tender in the case of small orders, but it did state that no auction or tender need be organized in the case of supplying agricultural production at government fixed prices. This norm simplified the procedure for rural SMEs to obtain orders, but it had little practical meaning because, at the end of 1991, the government fixed prices for agricultural products were revoked. Another positive moment that must be mentioned was the norm included in the resolution that if a number of suppliers offer the same conditions, preference is to be given to Latvian businesses. Although this can be considered a way of limiting competition, it should be remembered that at the time private business in Latvia was still in a stage of development (there were only SMEs), and this type of support on the part of the government was certainly useful. Regarding completion of the order once it was granted, the resolution provided that a contract be made and that disputes be heard in court. It should be noted here that under the civil procedural legislation existing in 1991, hearing a case in court meant paying a state fee of 10% of the amount of the claim and thus the ability of SMEs to defend their interests in court were severely curtailed because of financial considerations. From the viewpoint of SMEs the norm included in the founding law providing that contract terms could be changed and long term contracts (more than a year) terminated early if it had become disadvantageous to the supplier, was very important. Between 1991 and 1992 inflation was high in Latvia, which unfavourably affected SME finances in long term transactions.

On March 1, 1994 the CM passed regulations No. 60 which replaced CM Resolution No. 250 passed on September 26, 1991. These regulated in more detail the procedure for obtaining public procurement. They did not contain significant changes. Tender and auction were still the main ways to grant orders. It was provided that an auction or tender need not be organized if the value of the order was under Ls 2,000, also if supplies were intended for the needs of government material reserves. In part this norm is unfavourable to SMEs, because it not only increased the subjective element in reviewing bids, but also precluded publicity, thus businesses lacking in contacts in government structures (mainly SMEs), could be pushed out of the procedure for getting orders. From the viewpoint of SMEs, a positive factor was the retention of earlier regulations of the CM approved resolution concerning preference of RL businesses and opportunity to change long term contracts if it proved to be disadvantageous. It should be noted that CM Regulations passed on March 1, 1994, as opposed to the two CM resolutions reviewed earlier, did not mention municipalities as clients for the purposes of these regulations, meaning that municipal institutions needed not apply the procedures and norms provided in the regulations. Since during the period the end of 1994 division of government and municipal economic and financial competence was completed. Omitting this norm from the regulations caused a lack of legal regulation of municipal operations in this area. Thus a

basis was laid for uncontrolled municipal transactions lacking in transparency involving commercial structures. The main victims were SMEs, especially in the regions.

On October 24, 1996 the issue of government and municipal orders was settled by law. The Saeima enacted the law "On Government and Municipal Orders" which introduced a single and detailed procedure for granting government and municipal orders and replaced the CM Regulations adopted on March 1, 1994. The law applied to government and municipal orders for supplies, services and work if value of the order reached Ls 5,000 (in case of construction, Ls 50,000). In 1998 the law was amended, supplementing a norm that it applied to construction planning if value of the order is Ls 10,000 or more. The law did not apply to orders related to national security, national defence or establishing of material reserves, if each individual case had been decided by the CM. This leads us to conclude that, compared to the CM Regulations adopted on March 1, 1994, the requirement that the order be made public (namely, observe the public procedure provided by law), also applied to municipalities as clients. On the other hand, the scope of objects of the orders was narrowed, significantly increasing the maximum ceiling of the value of the order to which the public procedure could be ignored. Therefore it is not possible to analyze here with any certainty the influence of these norms on business, among them SMEs. It must be reiterated that the lack of a public procedure affects most severely interests of SMEs, because of the inability of SMEs to informally influence the process. From the viewpoint of SMEs a negative factor is also the norm incorporated in the law, delegating authority to the CM to ignore norms of the law in a number of cases.

The law rendered null and void the norm retained in the CM Regulations of March 1994 to give preference to RL businesses; furthermore, it provided that in cases when the value of the order exceed Ls 104,000 (Ls 4 million in case of construction), it was mandatory to organize an auction or tender inviting candidates from other countries. This norm, provided by the desire of Latvia to harmonize its legislation with that of the EU regarding competition in the area of public procurement, must be viewed negatively from the standpoint of SMEs, whose ability to fight for such orders is obviously less than that of foreign businesses. It must be noted, however, that the CM is authorized to decide not to apply this norm if necessary to protect domestic manufacturers or prevent serious social problems. Regarding methods of granting orders, the law provides that the main method is by auction. However, in cases where the auction failed to give results or it is not possible to define the order in sufficient detail or if the order concerns research or training, the auction may be replaced by open or closed tender. On the other hand, in cases where the value of the order does not exceed Ls 10,000 and the order is for goods and services offered regardless of the government order, such order may be granted on the basis of a comparison of prices. From the viewpoint of SME interests, organization of price comparisons or closed tenders provides an opportunity to ignore a part of market partners at the very beginning of the process of granting orders.

From the viewpoint of SMEs a negative factor is also the norms incorporated in the law on checking qualifications of candidates to participate in auctions or tenders. The norm which merits support in itself, because it requires checking whether the candidate has the necessary financial resources, experience and reputation to complete the order, in practice creates opportunity to discriminate against SMEs by setting requirements concerning the basic capital, turnover, or length of prior operations of the business. Also the condition requiring as a mandatory condition precedent to obtaining the order under auction or tender procedures that the candidate has no tax debts, is directed on the one hand to improving tax administration, but on the other hand it may significantly affect the interests and further operations of a business undergoing temporary financial problems. In this situation, too, most difficulties in the defending of interests is experienced by SMEs.

It must also be noted that the law requires a detailed listing of criteria (not only prices and terms) which must be applied in evaluating the offers provided at auction. It is said, for example, that it must be taken into account how the acceptance of the offer will affect the balance of government payment, employment of the population, introduction of new technology and development of science etc. Unfortunately the legislator has failed to mention effect on SME development as one of the criteria.

Table 36 Changes to Legislation Concerning Public Procurement and Their Effect on Business

Title of Act	Clause	Content of changes	Effect on SME
Resolution of RLCM No. 207 "On Work and Supplies to Government Needs" (26.11.1990)	1	■ Approves temporary founding law on providing work and supplies, stating that any physical or legal person may undertake to provide such work or supplies;	+
	2	■ Requires Ministries responsible for specific sectors of the economy to submit recommendations regarding the scope of work and supplies to the Ministry of Economy;	–
		■ Provides that the party completing the order is granted tax and credit relief if so stated in the contract.	
Resolution of RLCM No. 250 "On Approval of Founding Law on Work and Supplies for Government Needs" (26.09.1991)	4	■ The client is required, under equal conditions, to give preference to local businesses;	+
	6.3	■ Provider of work and supplies may receive tax relief as well as favourable conditions for obtaining raw materials, credit and trade licences;	+
	7	■ Provides that tenders and auctions are the way to granting public procurement;	+
	39	■ Provides that no tender or auction is required for supply of agricultural products at fixed prices, as well as in other cases;	+
	66.	■ Provides that the supplier may withdraw from a contract or ask that terms of the contract be changed if it has become disadvantageous for the supplier.	–
RLCM Regulations No. 60 "On Work and Supplies for Government Needs" (01.03.1994)	41	■ Provides that no tender or auction need be organized if the order does not exceed Ls 2,000, or if supplies are needed to ensure Government reserves;	+
	1	■ Does not apply to orders of municipalities and their institutions.	–
Law "On Government and municipal orders" (24.10.1996)	3	■ The procedures provided in the law apply also to municipal operations;	+
		■ Provides that tenders and auctions need not be organized if the work or supplies are intended for the needs of national security or defence as well as material reserves; also, no tender or auction is needed if the order does not exceed Ls 5,000 or Ls 50,000 for construction needs;	–
	5	■ Provides that candidate suppliers be checked, also with a view to their access to financial resources;	–
	6.	■ Provides that international tenders or auctions be organized if value of the order exceeds Ls 104,000 (Ls 4,000,000 in case of construction).	–
Changes to the law "On Government and municipal orders" (17.06.1998)	2	■ Provides that no tender or auction need be organized if the order is linked to construction planning and it value does not exceed Ls 10,000.	–
		Total "+"	7
		Total "–"	8
		Total "+ –" or "– +"	0

Conclusions and Recommendations

It must be concluded that Latvian legislative acts as a whole cannot be considered favourable in regard to granting public procurement.

The possibility should be considered to delete norms which indirectly worsen or may worsen the chances of SMEs to bid for government and municipal orders.

The effect on SME development as one of the criteria for obtaining government and municipal orders, or provide that a certain number of orders be granted solely to SMEs should be considered.

Summary of Conclusions and Recommendations

1. The rapid economic reforms and transition to a market economy have provided an opportunity for small and medium business to changing conditions and other additional difficulties, and to develop in new geographic directions and areas of new technology and quality. During this time, not only business people and the government but the entire population have come to understand the importance of the private sector which has a tendency to grow and has a stabilizing effect on society. A study of the conditions needed for development of small and medium business has been recognized to be a priority area, and one of its main tasks is to help develop a business-friendly environment. A diverse, well considered and EU oriented reform of legislation has created a functioning basis of legal acts; however, only in the past two years was increased attention given to the effect of its development on business generally.
2. Factors slowing down SME development are the shortage of finances, limited opportunities to obtain loans (high interest rates, little developed system of guarantees, lack of security), lack of business skills, insufficient knowledge of markets, various administrative obstacles (registration of business and obtaining necessary permits, licensing, ever changing reporting systems), frequent changes in legislation and the inconsistent application of laws.
3. One of the most important factors stimulating establishing of new businesses and growth of existing ones is a favourable and business friendly business environment. Following the renewal of Latvian independence, an average of 250 new laws are enacted and 350 CM regulations issued annually. Normative acts regulating business operations are changed monthly, and in this area quantity far outweighs quality, causing contradictions and uncertainty in application of norms as well as various administrative obstacles, all of which increase the indirect costs of doing business.
4. This study, similar to that carried out in Hungary, has mainly used the approach of legal experts in considering how changes in legislation affect business, thus the study may contain a certain subjectivity, and the reader should not consider the conclusions reached to be absolute. However, results of the work show sufficiently clearly that of the 592 changes to legislation analyzed by the study, only a little more than half (54%) have affected SMEs operations positively, about a third – negatively, and 16% of the changes have had both positive and negative or a neutral effect.
5. In order that future legislative development processes favour business operations and SME development, each intended amendment should be considered more carefully especially in those areas of normative acts where up to now negative changes have dominated. Such areas of legislation are:
   - normative acts regulating licensing;
   - residents' income tax;
   - foreign trade;
   - labour legislation;
   - public procurement.
6. Justification for each new normative act or amendment should consider its economic effect on and future consequences for business operations, among them SMEs. Such a constructive practice already exists in the Estonian Parliament[24] and a similar approach will soon be implemented in Latvia. It should be emphasized, however, that the consideration of the effect of a new normative act on the economy in itself does not necessarily draw attention to SMEs and, at present, does not include conceptual documents.
7. Although legislative acts have provided a procedure for giving government support, a mechanism has not been sufficiently prepared and laid down how increase in the competitiveness of businesses may be stimulated within the "acceptable limits" of the law. Since the government does not allocate

[24] OECD. Baltic Forum for Entrepreneurship and Enterprise Development. Policy Guidelines, Rīga, September 1999.

sufficient funds for the development of SMEs, and regions, and promotion of export, reality lags far behind need. The projects of state aid implemented to date have not affected the majority of business and a large part of businesses have not been informed of their existence or do not know how these projects are implemented.

8. The more important changes and supplements to the law "On Entrepreneurship" are linked to licensing, liquidation, satisfaction of claims and re-organization of businesses. The most negative effect on SME operations was caused by the regular extension of types of businesses needing a license. However, all in all, positive changes to the blanket law were much more numerous than the negative. Business owners, shareholders and partners had difficulty at first finding their way among the new laws.
9. A positive factor was the drafting of the Commercial Law and its present reading by the Saeima. This law will replace some fifteen various legal acts adopted in the area of commercial rights since 1990, and in the future will serve as a collection of normative acts related to business operations. The number of forms of business will be reduced (from twelve to five), relations between civil law and commercial law will be defined, present norms regulating business operations will be aligned, thus preventing contradictions and introducing a consistent terminology and principles of theory complying to EU requirements.
10. The types of business needing a license should be reviewed and regulation of those types where government or municipal interference is not necessary should be withdrawn (for example, international tourism, retail of motor vehicles, etc.). It is also necessary to simplify the procedure for issuing licenses.
11. The tax system laws and the changes introduced in it regarding SMEs have been loyal and have built a foundation of stability for establishing and developing future operations of SMEs. However, gradually the function of adding to the national treasury, which is at the basis of the tax system, should be organically supplemented so that it may stimulate business and encourage its growth. The frequency of changes to the legislation regulating taxes should be curtailed severely.
12. Normative acts of the legislator and the Cabinet of Ministers are supplemented by directives, notices and letters of the National Revenue Service, documents of individual municipalities and Ministries, which in many instances are not accessible to the public. Access to normative acts, transparency, simplification of administrative processes and reduction of bureaucratic obstacles are priority tasks for the government.
13. It is the duty of employers to calculate and pay the income tax of their employees. Frequently employees' wages and salaries are deliberately shown on the books at minimum rates but are paid at much higher rates. These actions negatively affect national revenues. Not all employers agree with such actions. However, as long as the government position on issues of the tax-free minimum, introduction of a minimum and graduated tax rates, increase of tax relief is not significantly changed, a large number of businesses, especially SMEs, will be forced to save their money and develop their operations by attempting to find ways to avoid paying taxes.
14. The social tax is the heaviest burden for employers, and especially SMEs. The security of any person demands significant additional expense. Employees, under conditions of low average wages, are unable to take care of their own social security.
15. Taxes and dues must perform one of their main functions: to promote the country's social and economic development, increase employment. An increase in the total amount of tax revenue must be achieved by increasing the foundation on which taxes are levied (increased income of residents and business, turnover of goods and services etc.), not by increasing taxes.
16. Adoption of CM Regulations "On Government dues on Protection of Industrial Property" in 1998 which replaced the rates laid down in 1992 on services of the Patents Board, was a decidedly negative factor. For residents of Latvia these regulations significantly increased their costs of legal protection. Similar to any increase in taxes and other mandatory payments, the increase in these rates, too, must be considered a negative factor, slowing down the private sector.

17. The SMEs must be interested and involved in the process of drafting legislation and a constant dialogue with the government. To this end the representation of the SME sector must be strengthened in the consultative processes, discussing changes in the tax burden, national programmes, government support policy, financial incentives and grants available to business. Regarding the latter, it is advisable to conduct regular analysis to achieve a feedback, efficiency, fairness and direction of projects.
18. From the viewpoint of business development, establishment of a mechanism for legal monitoring is important, and would prevent the massive copyright violation which can be observed at present in Latvia. A reduction of government dues on protection of industrial property is desirable.
19. It is desirable that the Latvian Mortgage and Land Bank be developed into a state-owned credit facility specializing in lending to SMEs, or in a more extended sense, a development bank. For the purposes of developing mortgage lending, land reform must be speedily completed and restrictions to credit facilities to emit pledge (mortgage) notes must be withdrawn.
20. The Latvian legal acts concerning granting of public procurement to SMEs cannot be considered to be positive. The possibility of deleting norms which accidentally limit or may limit SME opportunities to bid for government or municipal orders should be considered, as well as those which consider SME development to be one of the criteria for obtaining government or municipal orders, else provide that a certain number of orders should be allocated directly to SMEs.
21. Labour legislation does not favour the employer, thus reducing the ability of SMEs to manoeuvre in the labour market. Because of the important changes in the national economy, a new codification of norms of labour rights should be considered. In regulating relations between employers and employees, the autonomy the parties should be increased in accordance with general principles of civil rights, thus ensuring a real equality between SMEs and employees.
22. Adoption of final decisions on permitting or not permitting activities which affect the environment should be entrusted to environmental protection institutions rather than municipalities. The possibility should be considered of providing the government or municipal support to SMEs at certain times when carrying out or paying for studies assessing the effect of business operations on the environment.
23. Latvian legislative acts concerning allocation of public procurement cannot be considered favourable. The possibility should be considered of deleting norms which indirectly limit or may limit SME opportunities to bid for government or municipal orders.

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