

Executive summary

Like other economies in Eastern Europe and the former Soviet Union, Latvia underwent major economic and social change since the early 1990s. The transformation from planned to market economy was accompanied by fundamental reforms of political institutions and integration into the European Union and, in 2014, into the euro area.

Over the past two decades, economic growth has been impressive, narrowing the income and productivity gaps relative to wealthier EU and other OECD countries. But the global financial crisis resulted in a deep recession and one of the worst output losses in the world. Dramatic fiscal consolidation measures, soaring unemployment and unprecedented nominal wage adjustments caused wages and family incomes to plummet. Since 2011, output recovery in Latvia has been among the fastest in the European Union but GDP remains below the pre-crisis peak.

Despite the remarkable narrowing of national-income gaps relative to comparator countries, deep structural problems remain. Latvians reported very low degrees of life satisfaction in the boom years prior to the Great Recession, and measured subjective wellbeing is still among the lowest in the European Union and lower than in some OECD countries with lower or broadly similar GDP per capita. Income inequalities rose steeply and continuously prior to the recent crisis, from very low levels in the early 1990s (a Gini coefficient below 0.25) to one of the highest in the OECD (a Gini of around 0.35 since 2005).

Latvia's labour force participation is higher than the OECD average, but the labour market is very heterogeneous, with sizeable regional disparities, a very large share of low-paid jobs, and large minority groups who can face specific labour market problems. Highly volatile economic growth and one of the biggest income disparities in the European Union create a pressing need for effective social and labour market policies. Without sustained policy effort and adequate resources, there is a risk that inequality remains very high or, as during earlier recoveries, increases further.

A rapidly declining population – with a drop of 25% over 25 years – and the large shadow economy create substantial additional challenges for

maintaining growth and boosting inclusiveness. With an unfavourable demographic outlook, Latvia's future growth prospects rest on its ability to raise labour productivity by making the most of its available human resources.

A principal objective of this report is to support the Latvian Government in its stated aims and ongoing efforts to promote inclusive growth. It highlights the need to improve workforce skills, attract and retain talent, strengthen social protection and employment support, and tackle informality and labour market inequality. Concrete recommendations include:

- Sustaining efforts in key areas where significant policy progress has already been made, such as promoting work-based learning and enforcing applicable labour and tax law.
- Redoubling efforts in areas where they currently do not appear sufficient, such as connecting with Latvians abroad and promoting labour migration to ease current or future skills shortages in Latvia.
- A careful review of existing regulations, such as the minimum wage or formal language requirements for a wide range of occupations, to promote equal access to good-quality jobs.
- A more systematic evaluation of support measures, notably active labour market programmes, to identify best practice and help channel resources to the most cost-effective programmes.
- Making adequate social protection and employment support measures more accessible for those who need them, notably by improving coverage for jobseekers and addressing projected gaps in income security during old age.

Some recommendations imply a rise in public social spending that would require higher tax revenues or a shift in the composition of spending towards labour market and social policies.



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