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Doing Business in Latvia

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Introduction

Latvia, situated at the crossroads of Northern and Eastern Europe, is an increasingly attractive destination for entrepreneurs eager to capitalize on its unique blend of tradition and innovation. As a member of the European Union, the Eurozone, and the Schengen Area, Latvia offers a stable political and economic framework underpinned by access to one of the world's largest single markets. Yet, what truly sets Latvia apart for prospective business owners is its dynamic blend of business-friendliness, competitive taxation, and rapidly evolving support for startups and established enterprises alike.

Doing business in Latvia is not simply a matter of replicating strategies that work elsewhere. The country's relatively small but open economy is marked by a distinct blend of local business practices, sectoral opportunities, and regulatory specifics. From its thriving service industry to robust manufacturing and innovative knowledge-driven sectors, Latvia presents a landscape rich with potential—but also marked by unique rules, social norms, and administrative procedures that entrepreneurs must master.

This guide is designed to provide a comprehensive, on-the-ground perspective for anyone considering launching or expanding a business in Latvia. Unlike general business manuals, this book zeroes in on the specifics: the legal structures unique to Latvia, the nuanced process of company formation, intricacies of the local tax system, and the subtleties of employing and managing staff. We also unravel the details of Latvia's business environment—including government incentives, access to finance, and the realities of operating within the country's infrastructure and logistics networks.

Equally important, we explore the practical challenges and opportunities that define the Latvian market. Whether it's navigating the competitive landscape, overcoming administrative barriers, or leveraging the country's startup-friendly initiatives, our focus is on concrete guidance tailored to the realities of setting up business within Latvia's borders. Throughout, we pay close attention to business culture, communication norms, and etiquette, helping foreign entrepreneurs avoid missteps and build valuable local partnerships.

The foundation of this guide is depth, specificity, and a practical orientation. Each chapter addresses a core theme with actionable insights, clear explanations, and up-to-date information relevant to 2024 and beyond. Whether you are a first-time founder, an established business owner exploring expansion, or an investor seeking promising opportunities, this book is crafted as your definitive source for succeeding in the Latvian business environment.

Let this guide serve as your trusted companion on the path to launching and growing your business in Latvia. By understanding not only the formal requirements but also the distinct character of the market, you'll be better prepared to thrive in this vibrant, strategically positioned Baltic nation.

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CHAPTER ONE: Latvia's Economic Landscape: Facts and Figures

Embarking on a business venture in a new country requires more than just a good idea and entrepreneurial spirit; it demands a solid understanding of the economic terrain you're entering. Latvia, a Baltic nation that has navigated a remarkable path from Soviet occupation to a dynamic European Union member state, presents a unique economic profile. It's an economy characterized by openness, resilience, and ongoing transformation. While not one of Europe's economic giants in terms of sheer size, its strategic position, integration into the EU framework, and focused development efforts make it a compelling case study and, potentially, a rewarding base for business operations.

Understanding Latvia's economic landscape means looking beyond headline numbers. It involves appreciating its journey, recognizing its current structure, acknowledging its challenges, and identifying the trajectory it aims for. This chapter delves into the essential facts and figures that paint a picture of the Latvian economy, providing the foundational knowledge prospective entrepreneurs need before diving into specific sectors or regulatory details. From the scale of its Gross Domestic Product (GDP) and trade patterns to the nuances of its labor market and investment climate, we'll explore the quantitative dimensions that shape the Latvian business environment.

Latvia operates a small, open economy, heavily integrated with the wider European market. With a nominal GDP hovering around the USD 40 billion mark (approximately EUR 37-39 billion, depending on exchange rates and the year), it doesn't compete in scale with continental powers like Germany or France. However, comparing GDP in absolute terms only tells part of the story. For a nation of fewer than 1.9 million people, this output signifies a reasonably developed economy, classified by the World Bank as high-income. Its economic journey since regaining independence in 1991 has been dramatic, marked by rapid liberalization, deep recessions – notably the severe downturn in 2008-2009 following a period of overheating – and subsequent recoveries driven by painful but necessary reforms and strong export performance. Membership in the EU since 2004 and the Eurozone since 2014 have been pivotal milestones, anchoring the country firmly within the core structures of European economic and monetary policy.

Looking at economic growth provides a more dynamic perspective. Latvia experienced periods of extremely rapid expansion in the mid-2000s, earning it the moniker "Baltic Tiger," alongside Estonia and Lithuania. This boom was fueled by readily available credit and strong domestic demand, but it proved unsustainable, leading to one of the

sharpest economic contractions globally during the financial crisis. The recovery, though challenging, demonstrated the economy's adaptability. Growth patterns in the subsequent decade were more moderate but generally stable, often outpacing the EU average. Recent years, however, have brought fresh turbulence. The COVID-19 pandemic caused a relatively modest contraction compared to some other European nations, followed by a rebound. Yet, the geopolitical shockwaves from Russia's full-scale invasion of Ukraine in 2022 significantly impacted the region, bringing energy price volatility, supply chain disruptions, and heightened uncertainty, again dampening growth prospects. Future growth hinges on navigating these external shocks, boosting productivity, and successfully implementing structural reforms aimed at fostering higher value-added activities.

While overall GDP provides a national snapshot, GDP per capita offers insight into average living standards and economic output relative to population size. Expressed in Purchasing Power Standards (PPS), which accounts for price level differences, Latvia's GDP per capita has steadily converged towards the EU average, though it still lags significantly behind wealthier Western and Nordic European nations. It typically sits around 70-75% of the EU average, placing it ahead of some Eastern European peers but behind its Baltic neighbors, Estonia and Lithuania. Closing this gap remains a key long-term objective, necessitating sustained increases in productivity and investment in human capital and innovation.

The composition of Latvia's GDP reveals a modern, service-oriented economy. The service sector is the undisputed heavyweight, contributing well over 60%, sometimes closer to 70%, of the total economic output and employing a similar proportion of the workforce. Key sub-sectors within services include wholesale and retail trade, transportation and storage (leveraging Latvia's transit location), information and communication technology (ICT – a rapidly growing area), real estate activities, and financial services. Industry, encompassing manufacturing, construction, and utilities, accounts for roughly 20-25% of GDP. Manufacturing holds particular importance, with established strengths in wood processing, food products, metalworking, machinery, chemicals, and pharmaceuticals. Agriculture, forestry, and fishing contribute a smaller share, typically under 5% of GDP, although the timber industry, linked to Latvia's abundant forest resources, plays a significant role in both manufacturing and exports. This structure highlights the shift away from a primarily industrial or agrarian base towards a more diversified economy, albeit with ongoing efforts needed to move up the value chain within these sectors.

Given its size, Latvia's economy is inherently reliant on international trade. Exports of goods and services typically equate to a substantial portion of GDP, often around 60% or more, underscoring the country's integration into global and, particularly, regional value chains. The European Union is by far the most dominant trading partner, accounting for the lion's share of both exports and imports. Lithuania and Estonia, its Baltic neighbors, are consistently among the top partners, reflecting deep regional

integration. Other crucial EU markets include Germany, Poland, and the Nordic countries, especially Sweden. Historically, Russia was a significant trading partner, particularly for certain exports and as an energy supplier, but its importance has markedly decreased following geopolitical tensions and sanctions, prompting a necessary reorientation of trade flows.

Latvia's export basket is relatively diverse. Wood and articles of wood remain a cornerstone, leveraging the country's rich forest resources. Machinery and electrical equipment, base metals and articles thereof, and food products (including beverages and spirits) are also prominent goods exports. On the services side, transportation services have traditionally been a major earner, capitalizing on Latvia's ports and railway infrastructure connecting East and West. However, the export of modern business services, including IT, financial services, and consulting, has grown rapidly in importance, reflecting the economy's structural shift. Imports are led by machinery and equipment, mineral products (including energy), chemicals, and transport vehicles, largely reflecting the inputs needed for domestic industry and consumption. The trade balance often fluctuates, sometimes showing a deficit in goods trade which is partially offset by a surplus in services trade. Maintaining export competitiveness, diversifying markets further, and increasing the value-added content of exports are continuous priorities for Latvian policymakers and businesses.

Latvia's adoption of the Euro on January 1, 2014, was a landmark event, replacing the national currency, the Lats. Joining the Eurozone brought several perceived benefits, including the elimination of exchange rate risk for trade and investment within the currency bloc, lower transaction costs, and enhanced price transparency. It also signified deeper integration into the EU's core and potentially increased credibility in the eyes of international investors. However, membership also means that Latvia relinquished control over its independent monetary policy. Interest rates and overall monetary stance are now determined by the European Central Bank (ECB) in Frankfurt, based on the needs of the Eurozone as a whole. The Bank of Latvia (Latvijas Banka) participates in the ECB's Governing Council but implements the common policy rather than setting its own course.

This framework became particularly relevant during the recent surge in inflation that affected Europe and much of the world starting in 2021. Latvia experienced particularly high inflation rates, among the highest in the Eurozone, driven initially by soaring global energy prices (to which Latvia is quite exposed) and later broadening out to food and services. While the ECB responded with interest rate hikes across the Eurozone, the specific national circumstances and the differential impact of inflation across member states highlighted the challenges of a one-size-fits-all monetary policy. Managing inflation expectations and mitigating the impact on households and businesses, primarily through fiscal policy and targeted support measures, became a key domestic challenge. As global energy prices moderated, inflation began to recede, but its impact on purchasing power and business costs left a mark. Businesses

operating in Latvia must therefore factor in the dynamics of Eurozone-wide monetary policy and inflation trends, rather than purely domestic ones.

The Latvian labor market presents a mixed picture, reflecting both opportunities and significant challenges. The workforce is generally well-educated, with relatively high levels of tertiary education attainment, particularly among the younger generation. Multilingualism is also common, with proficiency in English and Russian widespread alongside the official language, Latvian, which can be an asset for international businesses. The official unemployment rate has fluctuated, falling significantly from the highs seen after the 2008 crisis but remaining sensitive to economic cycles. It often hovers slightly above the EU average, though recent years saw it trend downwards towards that average before the recent economic slowdowns caused a slight uptick.

However, aggregate unemployment figures mask significant regional disparities. The capital city, Riga, and its surrounding region typically enjoy much lower unemployment rates and higher economic activity compared to other parts of the country, particularly Latgale in the east. This regional imbalance reflects the concentration of investment, jobs, and infrastructure around the capital, posing challenges for balanced national development and creating pockets of higher unemployment and lower wages in peripheral areas. Youth unemployment, while lower than in some Southern European countries, has also been a concern at times, as has long-term unemployment for certain demographics.

Wage levels in Latvia have been catching up with Western Europe, but a considerable gap remains. Average gross monthly wages have seen respectable nominal growth over the past decade, driven by economic recovery, productivity gains (albeit slower than desired), and minimum wage increases. The national minimum wage provides a floor, regularly adjusted by the government; as of early 2024, it stood at EUR 700 per month. While this represents progress, the average wage is still substantially lower than in neighboring Estonia or the wealthier EU member states. This lower labor cost can be an attraction for businesses, particularly in certain sectors, but it also contributes to the persistent challenge of emigration.

Productivity growth is crucial for sustaining wage increases and improving competitiveness. While Latvia has made strides, labor productivity – output per hour worked – still lags behind the EU average. Enhancing productivity requires investment in technology, innovation, skills development, and more efficient business processes. Addressing skills gaps and mismatches between the education system's output and the labor market's demands is an ongoing focus area for policymakers, aiming to equip the workforce for higher value-added jobs, particularly in the priority sectors identified for future growth.

Attracting Foreign Direct Investment (FDI) has been a cornerstone of Latvia's

economic strategy since independence. FDI brings not only capital but also technology, know-how, management expertise, and access to international markets, all vital for a small economy seeking to upgrade its industrial structure and boost competitiveness. Latvia generally maintains an open and welcoming stance towards foreign investors, offering national treatment – meaning foreign companies are treated no less favorably than domestic ones in most sectors. The overall stock of FDI in Latvia has grown substantially over the years, reflecting sustained investor interest.

The primary sources of FDI into Latvia are other European countries, particularly neighboring and Nordic states. Sweden has traditionally been the largest single investor, heavily involved in the banking and telecommunications sectors. Estonia and Lithuania are also significant sources, indicating strong intra-Baltic investment flows. Other major players often include Cyprus, the Netherlands, and Germany, though the ultimate beneficial ownership can sometimes be complex to track. FDI flows have been directed towards various sectors over time. Financial intermediation historically attracted a large share, though its dominance has lessened somewhat. Real estate and construction, wholesale and retail trade, manufacturing (especially wood products, metalworking, and machinery), transportation, and ICT have all been important recipients of foreign capital. The burgeoning Global Business Services (GBS) sector is also increasingly attracting FDI. While specific large-scale investment incentives exist (covered later in Chapter 24 on SEZs and Chapter 21 on Support), the general investment climate relies on factors like EU membership stability, a relatively competitive tax system (discussed in Chapter 7), improving infrastructure, and the availability of a skilled, albeit potentially limited, workforce.

The structure of the Latvian economy is heavily dominated by Small and Medium-sized Enterprises (SMEs). Like in most European countries, SMEs form the backbone of the economy, accounting for the vast majority of businesses and a significant share of employment and value-added. This prevalence of smaller firms contributes to a dynamic and flexible business environment but can also mean challenges in terms of accessing finance, scaling up operations, and competing internationally. Policies aimed at supporting SME growth, innovation, and export capacity are therefore crucial components of Latvia's economic development strategy.

A defining structural feature is the pronounced concentration of economic activity in and around Riga. The capital metropolitan area is home to roughly half the country's population and generates an even larger share of its GDP. Most major companies, financial institutions, government bodies, and higher education institutions are located there. This concentration offers agglomeration benefits – proximity to suppliers, customers, skilled labor, and infrastructure – making Riga the natural first point of entry for many businesses. However, it also exacerbates regional disparities, leaving other regions struggling to attract comparable levels of investment and talent. Efforts are underway to promote regional development through targeted investments, support for local entrepreneurship, and leveraging the specific strengths of different

regions (e.g., ports in Kurzeme, agriculture in Zemgale), but bridging the gap remains a long-term undertaking.

Despite its progress, the Latvian economy faces several persistent headwinds. Demographics represent perhaps the most significant long-term challenge. Latvia has experienced population decline for decades, driven by a combination of low birth rates (among the lowest in the EU) and net emigration, particularly following the 2008 crisis. While emigration flows have moderated somewhat in recent years, and there has even been some return migration and immigration (notably, recently, from Ukraine), the underlying trend of a shrinking and aging population poses serious challenges. It strains the social security system, reduces the available labor pool, potentially dampens domestic demand, and makes it harder to sustain growth. Attracting and retaining talent, both domestic and foreign, is therefore paramount.

Income inequality also remains a concern. While poverty rates have generally declined, the gap between the richest and poorest segments of society, as measured by indicators like the Gini coefficient, is often higher than the EU average. This inequality has social implications and can also act as a drag on economic potential if large parts of the population lack sufficient purchasing power or opportunities. Addressing inequality requires policies focused on progressive taxation, social safety nets, education access, and regional development.

The shadow economy, referring to undeclared economic activity and envelope wages (paying part of salaries unofficially in cash to avoid taxes and social contributions), has historically been a significant issue in Latvia. While government efforts, including stricter enforcement, tax system reforms, and promoting non-cash transactions, have aimed to reduce its scale, estimates suggest it still constitutes a notable portion of the economy. The shadow economy distorts competition, erodes the tax base needed for public services, and undermines fair labor practices. Continued efforts to improve tax compliance and formalize economic activity are essential.

Energy security is another critical consideration, brought sharply into focus by the war in Ukraine and the need to reduce reliance on Russian energy imports. Latvia has made progress in diversifying its energy sources, increasing the use of renewables (particularly biomass and potentially wind), and improving interconnectivity with neighboring EU energy markets (e.g., via electricity links with Sweden and Estonia, and the LNG terminal access via Lithuania). However, ensuring stable, affordable, and sustainable energy supplies remains a key priority, impacting both households and business operating costs.

In terms of recent economic performance, Latvia, like the rest of the world, navigated the disruptions of the COVID-19 pandemic. The economic impact was managed through government support measures, and a rebound followed in 2021. However, 2022 brought the severe shock of Russia's invasion of Ukraine. While direct trade links

with Russia and Belarus were curtailed, the indirect effects via soaring energy prices, high inflation, shattered consumer and business confidence, and supply chain adjustments were substantial, leading to a significant economic slowdown and even recessionary pressures in certain quarters. Growth remained subdued into 2023, hampered by weak external demand and the impact of tighter monetary policy on domestic investment and consumption.

Looking ahead, the economic outlook remains dependent on the geopolitical situation, energy market developments, and the recovery trajectory of Latvia's main trading partners in the EU. Forecasts generally anticipate a gradual return to modest growth, supported by potential recovery in external demand, the deployment of EU funds (including the Recovery and Resilience Facility), and ongoing private investment. Inflation is expected to continue moderating from its recent peaks but may remain somewhat elevated compared to pre-pandemic levels. The long-term vision for the Latvian economy centres on transitioning towards a knowledge-based, higher value-added model, focusing on innovation, digitalization, and sustainability. The priority sectors outlined earlier – such as ICT, biomedicine, smart energy, and bioeconomy – represent the intended engines of this future growth. Successfully navigating the current challenges while laying the groundwork for this structural transformation will be key to securing Latvia's future economic prosperity. For entrepreneurs, this means understanding both the immediate economic climate and the longer-term strategic direction of the country.

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