

STANDARD SUMMARY PROJECT FICHE

1. Basic Information

1.1 Désirée Number: **LE01.05.01**

1.2. Title: **Development of business environment in Latvia**

1.3 Sector: **Economic and Social Cohesion**

1.4 Location: **Latvia**

2. Objectives

2.1 Overall Objective:

To enhance the competitive advantages of Latvia by supporting key national priority sectors – Forestry and Knowledge Economy and thereby increasing economic and social cohesion (ESC).

2.2 Project Purpose:

To maximise the benefits of ESC by targeting a limited number of *projects of national significance*. These ‘Milestone Projects’¹ will be directed at supporting the realisation of key long-term development priorities and ultimately aimed at addressing the level of unemployment and boosting GDP growth. The Milestone Projects will form building blocks for the longer-term development of a new dynamism in business, industry, education, research, and public administration under the identified national priority sectors.

2.3 Accession Partnership and NPAA priority

Accession Partnership

Medium-term priorities: *Economic and Social Cohesion*: Develop national policy for economic and social cohesion in preparing for the implementation of a regional development programme and Community initiatives; improving the administrative structures, in particular clarifying allocation of responsibilities on regional policy issues; organising the budgetary system and its procedures according to structural funds standards, including appraisal and evaluation.

Economic criteria: Continue promotion of market-driven restructuring in the enterprise sector and improve conditions for the creation and development of private enterprises, with particular attention to small- and medium-sized enterprises.

NPAA

EL – 004 “To contribute to the development of competitive, flexible and adaptable national workforce in order to cope with pressure and market force within EU”

EL – 005 “Promotion of integration of the unemployed and job – seekers into the labour market”

EA– 006 “Creation of a favourable environment for investment in Latvia”

EL – 006 “Facilitation of SME establishment and further development by ensuring economy development and market-driven competition”

2.4 Contribution to National Development Plan

¹ In the context of this fiche the term ‘Milestone Project’ should be understood as a project with the capacity to make a significant positive impact to the long term development of the particular National Priority Sector where the project is located. In total six projects have been identified under Phare 2001 ESC Programme: Riga Science and Technology Park, Development of Karaosta Industrial Park in Liepaja, Baltic Cyber City in Valmiera, Development of basic infrastructure at industrial sites in Latgale region, Zemgale IT Region project and Baltic Pulp.

This project fiche is prepared in relevance to the following priorities set out in the National Development Plan Strategic Memorandum (NDP SM):

- creation of a favourable environment for the development of entrepreneurial activities and the attraction of financial resources
- diversification of the economy and orientation to products with high value added
- adaptation of the professional qualifications of labour force to future labour market requirements
- development of economic infrastructure
- balanced and sustainable development of regions

These contributors offer certain potentials to provide payback for the investments needed in such areas as education and innovation in creating new competitive advantage, in overcoming the limitations faced due to size in global economic terms, maximising natural resource exploitation, and amortising the investment costs of the State.

3. Description

3.1 Background and justification:

Since independence the Latvian economy and administrative framework has made substantial progress towards developing the necessary structures of a modern market based economy. After initial difficulties, much of the economy outside the utility sector had been privatised and the majority of employment is now in the private sector. The activity level of private initiatives, however, is not seen as high. There are 1.2 companies per 100 inhabitants in Latvia, whereas in Estonia this number is 2.4, and in the EU 5.0.

As to the main macro-economic indicators of the country GDP in 1999 was 3970.5 EUR per capita PPP. In 1996 it constituted 26 of the EU15=100 index. Total non-financial investments per capita 1998 in were 700 EUR, but foreign direct investments in the same period constituted 480 EUR. The economic recession in the wake of the Russian crisis in 1998 was followed by an important recovery starting at the end of 1999.

Though the major macro-economic aggregates do not indicate any major crisis in the Latvian economy but rather a process of recovery from the complications of the past, it does not suggest that a process of development and catch-up with West European neighbours is well established. What is particularly striking about the development of the Latvian economy is that the fall in total output from the pre-transition situation was the most severe of all the CEEC. While the decline in total output essentially ended in 1993, there has been only one year of high growth (1997 – 8.6%) since then.

One of the key national development challenges is reducing unemployment by creating more opportunities for productive employment generation. The unemployment rate has expanded since the last quarter of 1999 and amounted to about 7.8 per cent in the first quarter of 2000. Unemployment shows large regional differences. The eastern parts of Latvia are still particularly affected, with unemployment rates higher than 20 per cent.

The ESC 2001 programme is positioned to tackle the unemployment challenge in Latvia within a long-term strategic appreciation of the need for Latvia to prepare for the competitive challenges of increased integration in the European and Global economies.

The concentration on identified Milestone projects under the two national priority sectors (Forestry and Knowledge Economy) is designed to maximise the benefits of ESC funding for long-term national economic growth. This focus is an outcome of policy lessons from past Phare support measures and dialogue with the social partners. This process has identified the need to concentrate resources on supporting developments in a limited number of national sectors that offer significant potential for growth.

While key priorities, such as employment generation, have been identified in the evolving national development planning process (the NDP SM) concrete project proposals to realise these priorities have not

been created. Under these circumstances the Phare ESC 2001 is positioned to make a valuable contribution to develop and support projects of scale that will help drive the national development planning process.

It should be stated clearly that while the Latvian administration has identified a series of Milestone projects under the two key national priority sectors it does not have the capacity or experience to carry out a full project feasibility analysis to ensure their successful impact or their suitability in realising national development goals. As such the PPS (LE 9914) will be used to carry out feasibility analysis on the identified projects under the two national priority sectors. Furthermore a component has been built into the ESC 2001 (Component 1 Preparing, Co-ordinating and managing Milestone projects) to develop this capacity for future ESC funding programmes and ultimately funding from Structural funds.

3.2 Linked activities:

The design and format of the ESC is based on rich linkages with on-going and future policy support programme. Key synergic linkages with other programmes include the following:

Phare Project Preparation Support (PPS) (LE 99.14) - the incorporation of this project is an innovative feature of the Phare ESC 2001. The overall ESC 2001 programme is powered by key national priority sectors (through the Milestone Projects) and specific business related infrastructure and human resource development projects. Clearly, these identified projects require a degree of analysis, preparation and packaging to ensure their impact and suitability in realising national development goals. The PPS will be used to carry out this role. Moreover the use of PPS in this focused manner will promote superior project selection procedures and appraisal techniques within the Latvian administration. It is conditional on using the PPS that strong and dynamic inter-ministerial relation are developed, in particular between the Ministry of Finance (MoF) and the Secretariat for the Minister for Special Assignments for Cooperation with International Financial Agencies (SMSACIFA).

Support to Industrial Cluster Restructuring (LE 9812/01.0001). This project based upon 'cluster' theory, is involved in developing strategic re-orientation in a number of principal industrial sectors. The developments to date have reinforced the importance of building from existing significant economic contributors a new vision with a multidisciplinary, collaborative approach, in order to create new potentials. It has reinforced the importance of the linkages with education, training and research and has validated the importance of the elements of this project fiche. This project has highlighted the importance of a number of elements in the development of future competitive advantage. The concept for successful industrial clusters in a European and Global context is contrary to the traditional approach of value chain enhancement as historically defined. It is based upon a perspective of multidisciplinary, cross sector, collaborative, but potentially competitive, informal groupings of entities and skill sets. It is an entirely changed approach to viewing economic structures from the traditional industry or sector approach. In a transition economy this demands a changed perspective, strategy and approach to policy development and underlines the importance of co-ordination within the entire administration. This cluster-based approach offers new potentials for Latvia and can be fully integrated to an effective demand driven measures envisaged within this fiche.

Development of Institutional and Administrative Capacity for Regional Development (LE 0012.01). This twinning project with the French institution DATAR seeks to establish an integrated mechanism to empower the national regional development policy in Latvia and strengthen the management and co-ordination of Latvia for Pre-structural and Structural Funds.

Pilot Regional Development Strategy for Latgale Region (LE 9702.01.05/0001) - the project was completed in August 2000. was a very active participant in the elaboration of the Latgale Regional Development Strategy. Besides the main activity within the project, which relates to the elaboration of the strategy, basic training was provided in planning and project design for representatives of the Districts (so-called Co-ordinators) in each district. Also to be mentioned as a result of this project is the introduction of the regional partnership. The partnership succeeded in being established between different sectors - business, education, local government sectors etc.

Urban Development Pilot project/ Technical Assistance/Twinning (LE 9805.03/001, LA98/IB/SPP/02) – the project was completed in January 2001. Within this project was a PAA who worked very closely with the Regional Development Agency in Latgale and Ministry of Environmental Protection and Regional Development, who also took part in the process related to the elaboration of Urban Development Plan.

Economic and Social Cohesion Measures in Latgale region (LE 0012.02) – starting from the year 2000 Phare National programme provides funding for investments to be directed into economic and social cohesion aimed at reducing regional disparities within country. Main activities of the Phare 2000 Economic and Social Cohesion programme are (1) business support facility to promote the business environment by providing expertise and advisory support to SMEs and start-ups (2) investments into business related infrastructure proposed by local and regional authorities located in Latgale region. The said infrastructure projects should contribute to improve the business infrastructure environment and provide an incentive for further direct investments (3) human resource development where a range of training services for the workforces of enterprises and support to the vocational education and training institutions will be provided. Furthermore the lessons learned from programming, implementation and monitoring process of mentioned project will be taken on board in the implementation of the Phare ESC 2001.

Economic and Social Cohesion Measures in Zemgale region (LE 0012.03) – the activities to be implemented within this particular project is similar to those described above for Latgale region.

Socio-economic Programme e-Latvia – Ministry of Economy, 2000 – the prior goal of this programme is by facilitation of implementation of the immediate tasks for the establishment of information infrastructure to increase efficiency of the performance of the national economy and competitiveness, to accelerate prosperity of Latvian society in order to contribute to sustainable economy development in Latvia.

OECD Education Policy Review - Latvia, 2000, Ministry of Education and Science -outlines the major challenges of Latvia's government in the further development of education system (quality, access and equity, efficiency) and education policy. Provides strategic recommendations for improvement of all education sub-sectors and system issues.

Concept of Sustainable Development of Latvia **“Latvia: from Vision to Action”** elaborated by the leading economists in 2000. This concept proposes two major directions of actions:

- re-industrialisation of traditional branches of national economy as medium term activity;
- development of new post-industrial spheres, promotion of Research and Development, growing investments in high technologies.

“Vocational Education and Training 2000” LE-9703.01.01. Project 03 “National Qualification Structure”. Support to the VET strategic policy development, strengthening of management capacities, qualification infrastructure and college study programmes.

“Support of Development of Employment Policy for Labour Department and Latvian State Employment Service (LSES) in the context of EU accession” LE-97-5377.00. In the final report of the project there has been provided the following recommendations: a) the share of active labour market measures should be increased comparatively to passive measures; b) new active labour market measures should be introduced in form of job subsidies (job subsidies should be targeted at long-term unemployed and particularly to those with no work experience).

3.3 Results:

- The development and application of projects of scale that will increase the economic contribution of the two national priority sectors on a sustained basis.
- Increased opportunities for other investment and business related activities within the two national priority sectors by providing a more attractive business enabling environment to encourage and support Foreign Direct Investments (FDI)
- Stronger linkages between different partners (Government, Administration, Academia, and private sector) to support the national development planning process.

- Begin developing a project pipeline for future ESC Phare funding (including project identification, technical and financial engineering)
- Effective and efficient horizontal and vertical administrative relations within and improved capacity of the Latvian government and administration to meet “programming” challenges of EU funds

3.4 Activities:

The 2001 ESC programme is constructed as a single project consisting of four integrated components. These components are as follows:

1. Preparing, Co-ordinating and Managing Milestone Projects to facilitate and enhance the National Development Planning Process
2. Investing in Business Related Infrastructure
3. Investing in Human Resource Development
4. Administration and Management of the Programme

Please see Annex 4, which contains a matrix describing how these four components interact to meet the objectives of Phare ESC 2001 programme.

Component 1

PREPARING, CO-ORDINATING AND MANAGING MILESTONE PROJECTS

At present the Latvian administration lacks the required capacity to manage a project driven development programme of the scale envisaged under Phare ESC 2001. Therefore in order to implement the Phare 2001 programme successfully; the preparation, co-ordination and management of the milestone projects must be addressed as part of the ESC 2001 programme. The Latvian administration has to meet the following challenges:

- Position the role and function of the Phare ESC programme within the national development planning process
- Develop a professional and transparent administrative process to effectively manage the funds in conjunction with other funding sources
- Ensure projects presented for ESC co-financing support have the necessary scale to ensure real impacts and clear contributions to the NDP priorities based on professional feasibility and financial analysis to justify their strategic suitability.
- Identify and develop the co-financing relations between ESC funds, national and third party funds to provide leverage and to ensure long-term sustainability of support measures.

Failure to meet the above public administration challenges will undermine the effectiveness of the entire ESC programme. This component of the ESC 2001 programme is designed to develop the necessary administrative capability within the Latvian administration. The objectives of this component will be to:

1. Develop an inter-ministerial and inter-institutional framework for the identification and packaging into the Milestone project concept based on national priorities identified in the NDP process. In particular, this will involve building ‘real’ project engineering (financial, technical) and management capacity in key line ministries.
2. Establish more effective co-operation between the public and private sectors to build future competitive advantages with clear linkages between future support programmes such as Development of Institutional and Administrative Capacity for Regional Development and the Regional Partnership projects in Latgale and Zemgale (co-funded under the Phare 2000 programme).
3. Create dynamic project pipelines and managerial human resource strategies for future funding with the ultimate objective of being prepared for the challenge of Structural Funds.

The beneficiaries of this component will be:

1. Secretariat for the Minister for Special Assignment for Cooperation with International Financial Agencies as the institution bearing responsibility for the National Development planning process, strategic designing of the economic and social cohesion programmes, criteria and monitoring
2. Ministry of Finance as the institution bearing responsibility for operational and financial management of the economic and social cohesion programmes
3. Relevant ministries, national and regional co-operation partners

A budget amount of **1,000,000** EUR have been allocated for this component to fund expertise in realising these three objectives.

Component 2

INVESTING IN BUSINESS RELATED INFRASTRUCTURE

Latvia has one of the lowest proportions of public investment in business infrastructure of all the transitional economies aspiring to EU accession. The majority of capital expenditure to date has been on repairs of buildings and structures that had deteriorated as a result of a lack of maintenance.

In broad terms, the quality of business related infrastructure could be characterised as more or less the same throughout the national economy. The main discrepancy exists between the two “growth centres” and the rest of the territory of the country. The two present growth centres are the ‘Greater Riga Area’ and the City of Ventspils Area, (the largest port in the country). Importantly, the Phare 2001 programme does not exclude any of the territories from possibility to seek assistance for improvements of the business-related infrastructure.

As such the availability and efficiency in provision of business related infrastructure is seen as a crucial component for successful modernisation of the economy in Latvia leading to:

- Enhanced competitive advantage
- Sustainable (globally) productive and service activities;
- Improved factor skills and productivity;
- Reduced production costs;
- Overall strengthening of the economic environment.

For the purposes of the Phare ESC 2001 programme business-related infrastructure is targeted primarily towards (but not limited to) the following national capital stock, on a project driven basis:

- Transport infrastructure;
- Information and communication technologies;
- Institutional base for development of research, technology and innovations;
- Environment infrastructure that reduces the negative effects economic activity.

Phare co-financing will be made available if the specific project is contained within the parameters of a ‘Milestone project’, is integral to the development of regional specificity, and the feasibility and economic impact of the particular project, is justified.

The project promoters and final beneficiaries of the infrastructure projects will be:

- Local and Regional Municipalities;
- State Institutions.

The procedural stages of infrastructure project selection will be as follows:

- A. Selected list of projects agreed by the ESC Steering Committee, where project selection criteria will be based on clear linkages to the milestone strategy under the NDP SM, addressing Latvia’s economic and social challenges (e.g. employment generation, equal opportunities, catalytic effect, etc.)
- B. Appraisal and feasibility studies of the infrastructure projects, what will be financed under the PPS (LE 99.14)
- C. Final projects approved by the ESC Steering Committee

- D. Preparation of the technical documentation for the infrastructure projects. The preparation of the technical documentation will be done through PPS - LE 9914

Contractually this component will be implemented by a number of contracts to be tendered out as soon as the projects are selected and fully prepared, appraised and approved.

The minimum size of the infrastructure project is 500 000 EUR. The appraisal and feasibility studies and preparation of technical documentation for the projects to be financed under Phare 2001 will be done through LE 9914 PPS,

Strategic Management and Co-ordination of this component will be the responsibility of the Secretariat for the Minister for Special Assignment for Co-operation with International Financial Agencies. The Ministry of Finance will undertake programme management and financial control.

5,500,000 EUR have been allocated for the Business related infrastructure component, where at least **4,950,000 EUR** will be allocated for infrastructure projects within the National priority sectors – forestry and knowledge economy and maximum **550,000 EUR** will be allocated for the further development, preparation, appraisal and engineering (financial and technical) of specific business related infrastructure components of milestone projects for 2002 and 2003.

Component 3

INVESTING IN HUMAN RESOURCE DEVELOPMENT

A Memorandum on Lifelong Learning (LLL) summarises the EU Member states debate about the tasks and implications for the coming decade in the light of implementation of LLL concept. The memorandum contains several key messages on the strategic competencies to action LLL. Each country is responsible for their education and training systems according to their institutional circumstances. Latvia, aiming at speeding-up the transition period from standardised economy towards customised economy, has, as other EU and accession countries, urgently puts LLL into practice for two main reasons:

1. A central national development objective is for Latvia to become a knowledge-based economy and society. Access to up-to-date information and technical knowledge, together with the motivation and skills to use these resources effectively, are key to realising this objective
2. Education, in its broadest sense is the key to learning and understanding how to meet the challenges of planning one's personal life, contribute actively to society and learn to adjust the speed of change in a knowledge based economy.

European Employment Strategy (European Employment Guidelines) is focused upon support of Human Resources Development measures based on four pillars:

1. improving employability;
2. developing entrepreneurship;
3. encouraging adaptability of businesses and their employees;
4. strengthening equal opportunities.

The Human Resource Development section of Phare ESC 2001 incorporates these four pillars and focuses on interventions in three key inter-linked measures. These measures will combine with the Business Related Infrastructure component of the identified milestone projects under the two national priority sectors.

Measures 1 and 2 are strategically focussed upon contributing to competitive advantage development based upon experience gained in prior Phare programmes and inputs from institutions, social partners, investors and will incorporate outputs of the VET (LE97.03.01.01) programme. Measure 3 addresses the social challenges of ensuring that excluded elements of society (e.g. long-term employed) will have opportunities to access benefits from the milestone projects.

Measure 1 - Development of Education and Training.

Based on the broader education/training demands of the Forestry and Knowledge Economy Sectors and the specific education/training requirements identified through the project preparation process of the specific milestone projects, this Measure will lead to the introduction of new education and training resources through:

- Identification of anticipated future skill set needs
- Curriculum development, co-ordination, and recognition;
- Targeted vocational training development;
- Collaborative programme development with industry;
- Up-grading of training facilities;
- Broadening of student catchments areas.

Another field where the activities will be focused is skills and knowledge development for innovation and information-driven technologies.

Selected milestone projects under the Knowledge Economy National Priority will demand intervention in the existing education provision towards specific technological education with emphasis on innovation and the use of modern technologies. This measure will also focus on supporting hi-tech training needs as identified by the project preparation process of the identified Knowledge Economy Milestone projects. The main activities under this will lead to specific project based hi-tech training support such as:

- Development of new study programmes and recognised qualifications;
- Collaborative project based training development with industry and training providers;
- Up-grading of training facilities etc.

The success of this measure is heavily dependent on intensive dialogue and cooperation between the SMSACIFA, the Ministry of Finance, Ministry of Agriculture and Ministry of Education and Science.

Measure 2 - Increased accesses to business, operational management, vocational education and training.

In both the Forestry and Knowledge Economy Sector the significance of small and medium-sized enterprises is important but also the need for major 'pools' of economic activity where SME's will cluster is also recognised as a priority. This measure is designed to support potential SME linkages with the milestone projects by supplying business training to targeted SMEs based on the impact assessment of the project preparation of the milestone projects.

The main activities under Measure 2 will lead to the provision of business management and vocational education to targeted SMEs that can benefit from potential linkages with the milestone projects. Such activities may include:

- Identification of anticipated future skill set needs for SMEs in National Priority Sectors;
- Business Studies curriculum development, co-ordination, and recognition;
- Targeted SME vocational training to exploit impact of Milestone projects;
- Collaborative programme development with SME sectors and training institutions;
- Up-grading of SME training facilities.

Measure 3 - Promotion of Employability

Economic and social cohesion is aimed at boosting development and reducing disparities in living standards among the regions through support to economic development. The issue of reducing social exclusion needs to be addressed through ESC support. Special attention has to be paid to marginalised sectors of society (e.g. long-term unemployed) who should not be excluded from the benefits of the Milestone projects.

Based on the outcomes of the project preparation process the main activities under Measure 3 will lead to the introduction of targeted educational and vocational training programmes and courses by:

- training of the unemployed in occupations related to the selected priority areas, particularly forestry;
 - improvement of employability of unemployed youth through training and temporary employment for acquiring practical skills;
 - reintegration of women in the labour market through training and information support;
 - job placements in Milestone projects for the unemployed, including technical jobs and jobs for project support.
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Within the Human Resource Component grants will be provided for funding of two types of activities:

1. Service type activities
2. Co-funding of supplies and non-service type of activities

The preparation of the Special Guidelines for the above-mentioned 3 Measures will be the responsibility of the SMSACIFA (strategic management / programming, decision-making and monitoring) and the Ministry of Finance (operational management and control). The technical input for the preparation of the guidelines will be provided by the line Ministries (in particular Ministry of Welfare, Ministry of Education and Science, Ministry of Economy, Ministry of Agriculture, amongst others) and co-ordinated by the Secretariat for the Minister for Special Assignment for Co-operation with International Financial Agencies. The Special Guidelines will be subject to approval from the ESC Steering Committee and endorsement by the EC Delegation.

The Ministry of Finance will undertake operational functions according to the EU Phare Rules and Procedures.

The beneficiaries of this project component will be:

- Universities and colleges;
- Local and Regional training institutions;
- State Institutions;
- Private sector enterprises (SMEs);
- Partnerships between education, industry and research;
- Several local Employment Services operating in respective regions;
- Local Employment service in co-operation with local authority;
- Local Employment Service in co-operation with educational establishment (vocational school, secondary school or other type of educational establishment);
- Local Employment Service in co-operation with local enterprises.

In the case of a beneficiary from the private sector, it has to contribute contribution of a minimum 25% of the total project cost.

2 000 000 EUR have been allocated for Human Resource Development Grant Scheme.

Component 4

ADMINISTRATION AND MANAGEMENT OF THE PROGRAMME

The budget shall be used to support the institutions involved in practical administration and management of projects, as described in this fiche. This component concentrates on improving the operational and contractual process of managing the ESC 2001 and other programmes. The assistance within this component will be provided for activities such as:

- support to practical administration and management of funds;
- support to project administration systems at the central and regional level;
- support to evaluation of individual project proposals and operational monitoring of individual projects;
- publicity and information;
- auditing.

This support will be provided to the Secretariat for MSACIFA and the Ministry of Finance based on the management and administrative demands of the programme's guidelines. Maximum **500 000 EUR** shall be reserved for the administration and management of the programme.

4. Institutional Framework

A policy to maximise administrative simplicity that encourages transparency is necessary given the breadth of contributors to the programme. To realise this policy goal, a clear division of labour and task responsibilities is required where existing management skills can be maximised.

The Secretariat for the Minister for Special Assignment for Co-operation with International Financial Agencies will be responsible for strategic management and monitoring of the programme and the Ministry of Finance for operational management and control (see Annex 7 for details).

An Economic and Social Cohesion (ESC) Steering Committee will be established and will consist of representatives from the following institutions:

1. Secretariat for the Minister for Special Assignment for Co-operation with International Financial Agencies;
2. Ministry of Finance;
3. Ministry of Economy;
4. Ministry of Welfare;
5. Ministry of Science and Education;
6. Ministry of Environmental Protection and Regional Development;
7. Ministry of Agriculture;
8. Ministry of Transport.

The representatives from the Five Planning Regions (Latgale, Zemgale, Kurzeme, Vidzeme and Riga) will also participate in the ESC Steering Committee meetings.

The representatives of the private sector and other social partners at national and regional level will be invited as observers.

The EC Delegation in Riga will have the status of observer.

The main task for the ESC Steering Committee will be:

- Strategic decision on performance of the ESC scheme supporting National Development Policy goals;
- Co-ordination and overall monitoring of ESC activities ensuring their effectiveness and compliance with EU procedures;
- Responsibility for coherence of the ESC actions supported by the projects with priorities set in the NDP, HRD strategies, National Employment Plan, Rural Development plan and other policies;
- Approval of the Selection Criteria;
- Approval of the Special Guidelines for ESC programme;
- Endorsement of expert panels for the assessment and approval of project applications;
- Endorsement of the qualified and selected projects, in accordance with ESC Guidelines.

Regional Development Councils and their executive bodies – Regional Development Agencies will act as one of the sources of projects in the ESC Scheme. The Regional Development Council will be responsible for endorsing project proposals for implementation in their region. The main tasks for the Regional Development Councils within ESC Scheme are:

- providing a pipeline of project ideas that are relevant for the regions development that could be further developed into concrete projects, providing that the projects are in line with the NDP and the regional development plans;
- development of partnership with other regions and National level development institutions in order to develop regional-scale projects of National significance;
- assignment of the task of project development to their executive institutions RDAs;
- monitoring of the project implementation in respective region.

In respect of physical and business related infrastructure projects, the Latvian Development Agency (LDA) will support the Secretariat in establishment and planning of potential projects of scale. It will assist in the selection and agreement of outline project ideas; providing technical and economic development inputs, ensuring that project proposals when presented for evaluation are complete, comprehensive and economically justified in line with the NDP, the Financing Memorandum, and Special Guidelines and capable of full evaluation.

More detailed division of responsibilities and tasks will be elaborated within the Special Guidelines for Economic and Social Cohesion Programme 2001.

5. Detailed Budget

	Phare Support					
	Investment Support	Institution Building	Total Phare (=I+IB)	National Cofinancing*	IFI*	TOTAL
Component 1		1 000 000	1 000 000	111 000		1 111 000
Component 2	5 500 000		5 500 000	1 833 000		7 333 000
Component 3	2 000 000		2 000 000	667 000		2 667 000
Component 4		500 000	500 000	55 000		555 000
Total	7 500 000	1 500 000	9 000 000	2 666 000		11 666 000

6. Implementation Arrangements

6.1 Implementing Agency

Financial and Administrative Implementation

Contracting Authority
PAO: Mrs Valentina Andrejeva
State Secretary, Ministry of Finance
Smilsu Street 1, LV 1919

CFCU: Mr Armands Eberhards
Director, Ministry of Finance
Smilsu Street 1, LV 1919

The Operational management will be responsibility of Ministry of Finance (see Annex No 7 for details).

Technical Implementation

SPO: Ms Ieva Kalnina, Head of Secretariat for Minister for Special Assignment for Cooperation with International Financial Agencies
Smilsu 1, LV 1919

The Secretariat for the Minister for Special Assignment for Co-operation with International Financial Agencies will be responsible for strategic management and monitoring of the programme (see Annex No7 for details).

6.2 Non-standard aspects

Non Standard aspects will be explored and developed by CFCU.

6.3 Contracts

Component 1 – service contract for total amount of 1 000 000 EUR;
Component 2 – work, supply and service contracts for total amount of 5 500 000 EUR;
Component 3 – grant scheme for total amount of 2 000 000 EUR;
Component 4 – service contract for total amount of 500 000 EUR.

The possibility of Joint co-financing procedures will be applied whenever it appears to be possible.

7. Implementation Schedule

7.1 Start of tendering/call for proposals

In view of the co-ordination with the current Phare Project Preparation Support (PPS) (LE 99.14) and the focus upon NDP (SM) goals:

- a) Draft ToR for Components 1 and 4 will have to be submitted for endorsement to the EC Delegation by 30 November 2001;
- b) Activities under Components 2 and 3 will commence no later than twelve months after the signing of the Financial Memorandum.

7.2 Project Completion

All contracts must be concluded in two years time period since the Financial Memorandum is signed. All disbursements must be made in three years period time since the Financial Memorandum is signed.

8. Equal Opportunity

Participation in the project will require professional qualifications and competence in the particular area and will allow an equal opportunity for men and women to participate in implementation of the project. Access to the project results will be equal for men and women

9. Environment

It is planned that each infrastructure project where it is necessary to be implemented within this programme should have elaborated project documentation including the environment impact assessment prior contracting. The possibility to finance mentioned documentation out of the LE 9914 Project preparation support could be explored.

10. Rates of return

Due to the breadth of potential projects within the proposed programme it is not possible to specifically define Rates of Return at this stage. Within the project proposal evaluation phase of the ESC 2001 programme it is proposed that with the:

- Private sector linked projects – the banking sector will be utilised as a partner to determine the economic and financial feasibility of identified projects.
- Physical and Business Infrastructure projects – the LDA will be utilised as a partner to determine the economic expediency and strategic goal contribution of identified projects

Project appraisal techniques appropriate to the approved projects will be utilised to ensure the projects have the intended impact and are sustainable over the long-term.

11. Investment criteria

11.1 Catalytic effect:

It is foreseen that the programme activities will have a catalytic effect by providing support to increased competitiveness within existing enterprises, encouraging the development of new competitive enterprises encompassing multidisciplinary elements, and nationally enhancing the development of competitive advantage of Latvia.

11.2 Co-financing:

One of the criteria for Phare support will be the potential attraction of other sources of funding as it was already stated earlier in the fiche, including the private funding where appropriate according to the state law on “State support to entrepreneurship”. Furthermore the attraction on funding from different IFIs and local banks is of crucial importance.

11.3 Additionality:

Phare funding will not be allocated to projects which can be solely funded by the private sector or which fall under exclusive support of other IFI's. Phare funding will not conflict or compete with funding activities of other financial institutions but will be complementary to leverage the effectiveness. The combination of Phare state / municipal budgets funding, will, for private sector projects, have a prerequisite of owners capital contribution, with a multiplier of funding from other sources (such as IFI's or banks or venture capital entities).

Infrastructure projects will be given priority where the potential exists in the project to leverage the investment to benefit a number of strategic business developments in the locality.

11.4 Project readiness and Size:

All infrastructure projects must be ready for contracting i.e. they must have comprehensive and satisfactory technical and financial feasibility. They must be linked to concrete investments by private enterprise, which must have commitments for the necessary capital or other finance. The projects must contribute to competitive advantage development in economic appraisal and feasibility studies. A demonstrated contribution to competitive advantage, commensurate with the investment required by the State and providing amortisation over an appropriate time-scale.

The minimum size for all business related infrastructure projects is **500 000 EUR**.

The minimum size for human resource development grant is **50 000 EUR**.

11.5 Sustainability:

The projects must be sustainable in the context of an enlarged EU in the long term. They must be implemented in compliance with EU norms and standards. They should not have adverse effects on the environment and must be financially sustainable. The incorporation of the banking sector and the policy of

ensuring private sector co-funding are partially designed to ensure project sustainability as well as to maximise the effect by size and significance of projects.

11.6 Compliance with state aids provisions

All investments into private sector will respect law on “State support to entrepreneurship”.

11.7 Contribution to National Development Plan

All investment projects will contribute to the NDP SM priorities as it is described in point 2.4 in this fiche.

12. Conditionality and sequencing

- Provision by 31 August 2001 of a medium-term human resource plan for developing professional capacity (administrative structure, qualified staffing, budgets, etc.) at key central authorities, as well as of an action plan showing how the various authorities will co-ordinate and co-operate. Both the staff / human resource and co-ordination / co-operation commitments must ensure the efficient implementation of the programme's objectives. The minimum required operational capacity would be put in place by 31 October 2001, according to the requirements of the plan.
- State and municipal budget will provide co-financing. Joint co-financing will be applied whenever it appears to be possible.
- Infrastructure projects proposed by municipalities and state institutions under component 2 are identified by the Latvian authorities, appraised by independent experts, approved by the ESC Steering Committee and endorsed by the EC Delegation, at the latest by 30 November 2002.
- Provision of special guidelines for the grant schemes under component 3 are approved by the ESC Steering Committee and endorsed by EC Delegation by 31 May 2002.
- Establishment of all the necessary structures and procedures for operating the schemes under components 2 and 3, endorsed by the EC Delegation by 31 May 2002.
- Draft ToRs for Components 1 and 4 will have to be submitted for endorsement to the EC Delegation by 30 November 2001.
- The Secretariat of SMSACIFA and the CFCU will submit quarterly activity reports to the EC Delegation as of 31 October 2001.

ANNEXES TO PROJECT FICHE

1. Logical framework matrix
2. Detailed implementation schedule

3. Cumulative contracting and disbursement schedule
4. Integrated project component matrix
5. Project proposals – Expanding the Economic Contribution of the Latvian Forestry sector
6. Project proposal – Building the Knowledge Economy
7. ESC Implementation Scheme

LOGFRAME PLANNING MATRIX FOR Project Development of business environment in Latvia	Programme name and number LE01.05.01	PHARE budget: 9 MEUR
	<u>Contracting period expires</u>	<u>Disbursement period expires</u>

Overall objective	Indicators of Achievement	Sources of Information	
To enhance the competitive advantages of Latvia by supporting key national priority sectors - Forestry and Knowledge Economy and thereby increasing economic and social cohesion (ESC).	<ul style="list-style-type: none"> Increased number of identified projects of national significance Increase the quality and significance and expediency of applications for ESC funding Increased contribution of key sectors to GDP growth Increased employment generation Project pipeline developed 	<ul style="list-style-type: none"> National statistical reports Studies by international institutions Commission reports 	
Project purpose	Indicators of Achievement	Sources of Information	Assumptions
To maximise the benefits of ESC by targeting a limited number of <i>projects of national significance</i> . These 'Milestone Projects' will be directed at supporting the realisation of key long-term development priorities and ultimately aimed at addressing the level of unemployment and boosting GDP growth. The Milestone Projects will form building blocks for the longer-term development of a new dynamism in business, industry, education, research, and public administration under the identified national priority sectors.	<ul style="list-style-type: none"> Expansion of National Milestone Projects Increased involvement of private and banking sector in project development and execution Increased efficiency of Latvian administration to manage ESC co-funded projects Nationally co-ordinated development of contributors towards potential future competitive advantage 	<ul style="list-style-type: none"> National reports and statistics Commission reports 	<ul style="list-style-type: none"> Political and economic stability Continuing and improving government commitment to the aims of the programme Availability of qualified technical assistance Existence of real partnership
Results	Indicators of Achievement	Sources of Information	Assumptions
<ul style="list-style-type: none"> The development and application of projects of scale that will increase the economic contribution of the two national priority sectors on a sustained basis. Increased opportunities for other investment and business related activities within the two national priority sectors by providing a more attractive business enabling environment to encourage and support Foreign Direct Investments (FDI) Stronger linkages between different partners (Government, Administration, Academia private sector) to support the national development planning process. Begin developing a project pipeline for future ESC Phare funding (including project identification, technical and financial engineering) Effective and efficient horizontal and vertical administrative relations within and improved 	<ul style="list-style-type: none"> Number of bankable projects implemented successfully Improved environment for FDI Increased contribution of key sectors to GDP growth Identifiable contributors of national significance towards potential future competitive advantage 	<ul style="list-style-type: none"> Monitoring reports Contractors reports 	<ul style="list-style-type: none"> Efficient programme management (implementation, monitoring and assessment) co-ordination between the implementing authorities, contacting organisations and

capacity of the Latvian government and administration to meet “programming” challenges of EU funds			other institutions
Activities	Means		Assumptions
<ul style="list-style-type: none"> • Preparing, Coordinating and Managing Milestone projects • Investing in Business Related Infrastructure • Investing in Human Resource Development • Administration and Management of the Programme 	<ul style="list-style-type: none"> • Component 1 - service contract for total amount of 1 000 000 EUR • Component 2 – work, supply and service contracts for total amount of 5 500 000 EUR. • Component 3 – grant scheme for total amount of 2 000 000 EUR • Component 4 – service contract for total amount of 500 000 EUR 		<ul style="list-style-type: none"> • Timely availability of co-financing resources • Effective use of PPS • Common understanding of involved institutions
Preconditions			
<ul style="list-style-type: none"> • Clear share of responsibilities among key institutions involved in the ESC Programme design and implementation; • Proper human resource capacity is in place in the Secretariat for the strategic management and monitoring purposes and within Ministry of Finance for operational management and control; • Partnership with regions established and better inter-ministerial cooperation developed • Committed co-funding from State Budget; • Special Guidelines approved by the ESC Steering Committee and endorsed by EC Delegation. 			

DETAILED IMPLEMENTATION SCHEDULE**Development of business environment in Latvia**

	2002												2003												2004												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	
Component 1																																					
Component 2																																					
Component 3																																					
Component 4																																					

CUMULATIVE CONTRACTING and DISBURSEMENT SCHEDULE (9 million EUR)**Development of business environment in Latvia**

	30.09.2002	31.12.2002	31.03.2003	30.06.2003	30.09.2003	31.12.2003	31.03.2004	30.06.2004	30.09.2004	31.12.2004
<i>Component 1</i>										
<i>Contracted</i>	1.000									
<i>Disbursed</i>	0.300	0.400	0.500	0.700	1.000					
<i>Component 2</i>										
<i>Contracted</i>		2.000	4.000	5.500						
<i>Disbursed</i>		0.700	1.400	1.900	2.600	3.100	3.500	4.000	4.500	5.500
<i>Component 3</i>										
<i>Contracted</i>		0.800	1.200	2.000						
<i>Disbursed</i>		0.600	1.000	1.600			1.800			2.000
<i>Component 4</i>										
<i>Contracted</i>	0.500									
<i>Disbursed</i>	0.150	0.250	0.300	0.350	0.400	0.400	0.400	0.450	0.450	0.500

Development of business environment in Latvia			ANNEX No 4
Preparing, Coordination and Managing Milestone Projects	INVESTMENTS		Administration and Management of the Programme
	Investing in Business Related Infrastructure	Investing in Human Resource Development	
<p>The objectives of this component will be to:</p> <ol style="list-style-type: none"> 1. Develop an inter-ministerial and inter-institutional framework for the identification and packaging into the Milestone project concept based on national priorities identified in the NDP process. In particular, this will involve building 'real' project engineering (financial, technical) and management capacity in key line ministries. 2. Establish more effective co-operation between the public and private sectors to build future competitive advantages with clear linkages between future support programmes such as Development of Institutional and Administrative Capacity for Regional Development and the Regional Partnership projects in Latgale and Zemgale (co-funded under the Phare 2000 programme). 3. Create dynamic project pipelines and managerial human resource strategies for future funding s with the ultimate objective of being prepared for the challenge of Structural Funds. <ul style="list-style-type: none"> • <u>SMSACIFA</u>: Strategic Development, monitoring, supporting inter-ministerial relations, jointly designing and co-ordinating programme & assessment systems* • <u>Ministry of Finance</u>: Excellence in Operational / Financial Management / Contractual management, jointly designing and programme delivery ** • <u>Relevant Ministries, national and regional actors</u>: Eligibility and Selection Criteria; Project Management and Delivery*** 	<p>For the purposes of the Phare ESC 2001 programme activities (on a project driven basis) within business-related infrastructure component will be targeted primarily towards (but not limited to) the following national capital stock:</p> <ul style="list-style-type: none"> • Transport infrastructure, for example to connect business with education/research/industrial activities, business with services and know-how, labour with workplace etc.; • Institutional base for development of research, technology and innovations; • Environment infrastructure that reduces the negative effects economic activity. 	<p>Integrate Human Resource Development Projects will be focused to contribution to competitive advantage development and social challenges through:</p> <ul style="list-style-type: none"> ▪ Curriculum development, co-ordination, and recognition; ▪ Targeted vocational training development; ▪ Collaborative programme development with industry; ▪ Up-grading of training facilities; ▪ Broadening of student catchments areas. ▪ Collaborative project based training development with industry and training providers; ▪ Collaborative programme development with SME sectors and training institutions; ▪ training of the unemployed in occupations related to the selected priority areas, particularly forestry; ▪ improvement of employability of unemployed youth through training and temporary employment for acquiring practical skills; ▪ reintegration of women in the labour market through training and information support; • job placements in Milestone projects for the unemployed, including technical jobs and jobs for project support. 	<p>Supporting professional capacity of programme implementation by:</p> <ul style="list-style-type: none"> • Addressing the Procedural and Strategic Relationships • Ensuring operating and financial management excellence • Efficient operating contractual and tendering systems to meet the programming challenges • Supporting project planning and delivery systems • Supporting Monitoring and Audit Excellence
Component 1	Component 2	Component 3	Component 4
<u>Funding Amount</u> Service contract for total amount of 1.0 MEURO with 10% co-finance	<u>Funding Amounts</u> Up to 10 works/supply/service contracts of 5.5 MEURO (ESC) with 25% co-finance,	<u>Funding Amounts</u> Grant scheme of 2 MEURO (ESC) with 25 % co-finance. Minimum 25% additional co-financing for private sector	<u>Funding Amounts</u> 0.5 MEURO (ESC) for Service Contract with minimum 10% co-financing

* Strategic relationship with Phare 2000 Twinning Project 'Development of Institutional & Administrative Capacity for Regional Development

** Expanding Capacity of CFCU to deal with increasingly complex contractual procedures in close partnership with the strategic responsibilities of SMSACIFA

*** Strategic Relationship with Phare Economic and Social Cohesion 2000 objectives

**** The Project Preparation Support (PPS) under Phare 1999 budget will be used to carry out feasibility analysis on selected projects.

Expanding the Economic Contribution of the Latvian Forestry Sector

The potential exists to develop competitive advantage and higher value added in this sector based upon an integrated restructuring of the participants, modernisation, new quality standard development and the application of a cluster approach to include multidisciplinary non-traditional contributors. The basis of the potential developments range from scientific inputs in such areas as seed development and treatments, upgrading forestry management and silviculture, recognised international certification, modern harvesting techniques and logistics, through primary and secondary processing, scientific research into alternative uses and design in its broadest sense.

The need to enhance long-term competitive advantage and add value in this significant sector is a priority and offers many elements that constitute a base for the preparation of project applications within the perspectives of ESC.

In upgrading professional educational and vocational training in the sector a significant potential contribution to competitiveness in this sector could be achieved. The effect of education and linked research in such potential areas as genetic management of seeds, composite material coatings of seeds to improve germination and growth – maybe based upon cellulose from further in the value chain (linked to pulp production), and the development of alternative uses for timber elements or extracted chemical constituents may produce significant future competitive advantages. All however require positioning of education and scientific research at the leading edge of global developments with strong industry linkages.

Present Industry

The present forest management and related sectors of industry in Latvia have a number of unique advantages that can be built upon, but also a number of handicaps that may prevent the development of robust competitive exploitation with strong added value. In the context of this fiche the Forest Cluster will refer to the management of forestry generally and the downstream added value processors.

Within the nascent ‘forest cluster’ there are some companies that have initiated strategic change processes, realising their activities/products must change against the background understanding of the needs for modernisation and efficiency.

Current Situation.

Forest Resources - Approximately 44% of the forest resources are owned by private owners, with an average holding of c.18 hectares. Management of these resources is characterised by owners who look after their forest resources themselves, with limited knowledge and understanding of modern silvicultural practices.

The state forest resources are managed by a JSC, with long-term cutting rights for harvesting contracted to commercial companies. The common practice at present for thinning is in a form of strip felling due to equipment and machinery limitation, however, this has begun to change as modern equipment is allowing more silvicultural selection. Within the harvesting operations there is very little selection or identification of timber product applications that would allow added value products to develop, (such as telegraph pole, fencing material). This is a reflection of the lack of market and poor equipment available. There is poor control over the state forest with the theft of trees and logs, and in the private sector with potentially illegal felling of trees.

Replanting is undertaken with bare root crops, which takes longer to become established and the survival rate is often low, compounded by the methods of weeding and pest control.

Small productivity units - Presently there are a large number of small sawmills that are not able to supply directly into the export market. They are relatively small and not able to provide suitable volumes or the product range required. This has allowed a number of “accumulators” both Latvian and foreign companies to develop a business that trading timber from local sawmills to the foreign markets, effectively reducing margins for the producers and restricting their development.

Disposal of Residues - With the lack of facilities within the country that will accept forest industry residues, there is constant and increasing problem that timber processors have to dispose of waste. Presently the environmental issues are increasing with many thousands of tons being either burnt but more commonly dumped into quarries, waste ground or wet marshland. However, there are some communal boiler plants that can utilise wood waste materials.

Non transparent industry – By the nature of the product there is a large amount of activities within the forestry sector and in primary processing that almost certainly take place with unaccounted cash transactions. This may be done in a number of different ways due to the set of local circumstances and activities and it is difficult to state any clear continuous and cross industry irregularities.

Education and training - The recent advance in technology with new types of equipment and management practices used internationally within the forest industries has led to a gap between the educational understanding and industries trends, pressures and economics. There is a growing demand for middle/lower management and technicians, that today are outside the curricula offered by the education system. State driven industrial training skills linked to national programmes with suitable focus for a modern forest industry are lacking leaving companies to develop their own staff.

Market Pressures and Economics - The industry operates in a commercial market with exposure to the foreign competition with all the complexities of the free market and the wide range of economic influences. This has led to a number of producers working with “accumulators” who provide some perceived form of security of payment for the product. Due to limited understanding of market trends and demands concerning quality, reliability and presentation, often the main tool to generate sales is solely price levels. Linked to the volume issue, and the lack of direct customer contact, there is no real in-depth knowledge of the international industry economics and understanding of the different influences and pressures that affect the purchasing decisions. This means that companies are often only reactive rather than proactive, which does not lead to competitive advantage.

Lack of critical mass in secondary processing - There are many secondary processors who are of varying size and capacity producing a mix of different products with little standardisation between them. This has led to the sector having problems to gain large or constant contracts; companies often work through agents and again have limited understanding of market prices and trends. Larger factories have developed good contacts leading to longer term contracts and consequently have begun to develop medium term strategies. There is an understanding that at the present levels and size, their businesses may not be sustainable, so growth and development are imperative for survival. A number of primary processors are moving into secondary processing, this often causes a cash flow problem and therefore restricts the growth of the business.

Limited Niche Products - Due to limited market exposure which has led to insufficient understanding of the market trends plus required additional capital, there has been limited growth within the niche market products that may give the producer a better margin and growth within the sector. However, there are sectors such as fencing products, log cabins and garden items that have had success, but many are relatively small and have limited market penetration.

Many of the primary processors are adding value to different timber products. This is commonly done with the outlook of increasing the product margin but with little understanding of true costing. With increasing competition the minimum added value is needed as a tool to sell the product, as the foreign competition add value as a standard and as a method of increasing the product quality.

Future Sector Needs

A successful and competitive forest industries cluster will consist of a number of different sectors of the industries of today and new entrants, and will be inter-linked and reliant upon the forest resources.

The Latvian forest cluster must be competitive against other Baltic Sea forest clusters, such as those in Sweden and Finland. Latvia can gain from these by utilising the technology and techniques and building specific unique advantages. A unique competitive advantage can be envisaged with the potential to include a larger added value and secondary processing timber sector that can produce a number of niche products in the future. Therefore focus must be given to all the different elements within the forest cluster.

Utilisation and Management of Forest Resources - The market pressure for the forest industry products has led to the need for the internationally recognised FSC (Forestry Stewardship Council) certification. This provides assurance to the customer base that the forest products have come from a well-managed renewable forest resource and can follow a chain of custody. With modern silvicultural forestry management and harvesting practises the forest resources will be able to increase in quality, growth and production. If the tree nurseries develop a practice of root cell, there would be less transition/dormant period after planting and the opportunity to plant larger seedlings, thereby leading to a higher success rate and quicker growth within the first years. To ensure that forestry produces the maximum yield with suitable quality, it is important that there is weeding, pest control and controlled selective thinning done. During the planning selection for harvesting it is important that forestry management have an understanding of the market and its influences. This is also important during harvesting processes to ensure that there is maximum flexibility towards the markets.

The correct equipment and machinery is very important for the efficiency and flexibility in order to service the market. To ensure that the equipment does not damage forest, there must be an understanding of the equipment available and its capabilities, thereby preventing any ground damage. This is important within Latvia as it has large areas of “wet forest” and has some unique natural attributes such as the black storks and beaver population.

True forest inventory and policing is very important to ensure that there is an understanding of the growth, leading to the management and harvesting plans. Amenity forestry is an important aspect of the forestry sector as it is able to provide a wide range of extra rural activities.

Efficient Sawmills - With increasing European forest resources, the market will become more competitive despite the expected increase in the use of forest products. Therefore, it is important that sawmilling sector is able to be highly efficient and proactive to the market needs and demands. Automation in the sector is reducing the response time; thus, in order to gain a competitive position investment is required into modern automatic equipment. The primary processors must develop highly efficient automated lines with the ability to add value to the raw material creating a sales advantage for the products and in turn providing quality assurance.

Small Log Processors - A large processor of small logs will create constant demand for the small log production from the forests, either from the thinning or the tops of the main harvesting. This demand will ensure that there is a greater stability in the price for the forest raw material, (removing the high fluctuation of small log prices). This type of activity will accept some sawmill residues thereby supporting the sawmill development and mechanisation. This type of demand will enhance the forest quality with correct management and can lead to additional small log processing operations in the future.

Secondary Processing Sector - Development of Latvian secondary timber processing sector that is competitive and flexible towards market demand can play a vital part within the forestry cluster, as the sector will require increasingly large volumes of timber. This will be an important market for semi-processed forest products, as the sector will demand a set of quality standards leading to maximisation of the forest resources by product quality being identified in the raw material.

Product Diversification - An increased range of products produced by the cluster will improve the cluster performance and competitiveness, as the new activities and innovative ideas will be stimulated within different sectors of industry. It will also create a more competitive environment for raw materials and develop uses for the forest industries residues.

E-commerce net for trading and more efficient transactions – The ability to conduct commercial transactions between the supply base and the customer in the most cost-effective way will be important. The forest industries' products in many sectors are becoming commodities with lowering margins. Presently it is expected that e-commerce will become more important for commercial transactions and the understanding of the development of contracts. More work will be done between the sales team/customer, controlling and drawing down from unshipped stock in response to market needs.

Cost Effective Energy - The forest processing industries require a lot of energy therefore it is important that energy costs are kept as low as possible. Bio-energy plant could play a part in this but there will be considerable need for major investments.

Efficient Logistics - The low-margin and highly competitive forest industries will require efficient logistical services at competitive rates; this applies to both bulk cargoes and the smaller container/truck loads. To gain this, there are various sectors of the logistics sector, which are included in the process of exporting goods, national road development, ports authorities, customers and inspection authorities, and freight companies.

Education and Research - Education that is focused towards the needs of the industry must ensure that the industry is able to employ the most suitable staff for the company's development and growth. To aid this, the industrial sector must also have a close relationship with educational and research institutes able to advise on the market trends and industrial developments. Industry and research institutes should develop a closer working relationship with each other allowing development of new products with an understanding of product application and market demand or trends.

Outcome and Results.

The Economic and Social Cohesion programme in the Forest cluster focuses upon developing:

- **Improved resource exploitation** - Increased demand from the processing sectors for additional volumes of raw material and increased quality will ensure that the forest management maximises forest resources with good forestry management practices, such as forestry certification and supply chain management.

- **New activities and products** - To provide a more stable forest industries cluster that will be less affected by any single change or influence within the market.
- **Employment prospects** - A strong forest industries cluster will provide a future career for the younger generation and develop pride in the forestry industry and international recognition.
- **Increased log/raw material price** - Forest value and log prices in the east of the country would increase due to a constant demand with limited transportation costs.
- **Greater stability of log/raw material prices** - The pulp mill or other processing facility that would require large volumes of small log raw material within the country there would be less fluctuation in the raw material prices.
- **Research and development** – The forest cluster will maintain its competitive advantage if it is able to develop new products that allow it to lead the market in certain sub-sectors, thereby providing a unique aspect to the cluster. To ensure that there is a sustainable advantage within the new products, research institutes must be used to constantly develop the next generation of products.
- **Increased foreign earnings** - A competitive Latvian forestry cluster would produce a wide range of different value-added forest products. This will ensure that there is foreign revenue from different international markets removing the exposure to an economic downturn in any one country.
- **Improved infrastructure** – The forest cluster will require good logistics network, so improved road, rail and port infrastructure will be established around the country.

Potential Projects.

As detailed in the fiche development of specific infrastructure projects will be undertaken with the current Phare Project Preparation Support (PPS) and Components 1 and 2 with focus upon NDP (SM) goals. As it regards the human resource development activities the selection criteria will be elaborated further on. However for the time being it is inappropriate to present specific projects to be financed out of the Phare 2001 ESC Programme.

The above section presents identified needs upon which a number of Milestone Projects could be based. Furthermore a broad input from institutions, industry and social partners and existing projects would be sought in order to extend and affirm the perceived needs, which following indicative projects could be included in the Forests Cluster Milestone concept:

1) Development of business infrastructure

Within the current project 'Support to Industrial Cluster Restructuring' (LE 9812.01/001) a number of nascent clusters, linked to Forestry, ICT and high-tech innovation are in development. Based upon the Future Sector needs described above for the Forestry Cluster, a number of other project targets that fit within the Milestone definition will require further consideration and development in the PPS and Component 1 and 2.

The following are therefore an indicative of the strategic type of project that might be appropriate:

i) Support Modern Industrial Development

The integration of modern technology into the Latvian forest industry needs to be undertaken, as the European market is highly competitive and the product unit cost is critical in matching the market expectations to ensure sales.

The programme could support:

- Research and foresight development;
- Identification of future potentials;
- Coordination and rationalisation of enterprise support to facilitate development;
- Stimulation of structural enhancements to meet future market needs;
- Facilitation of private investment;
- Security of the raw material supply chain;
- Cluster development by enhancing Legislation and Regulations.

ii) Encourage the service sectors to utilise technology

Competitiveness in the Forest cluster (and others) must be supported by a modern and efficient service sector, particularly logistics within European context:

The programme could support:

- Development of more efficient and enhanced road / rail / sea infrastructure links, network integration and administration;
- Review of the limitations for modern logistic operations;
- Potential revisions to legislation to support logistics operations (for example for forest products transport the possibility for road trains, increased weight limits);
- Review the limitations to accelerated cargo operations to improve competitiveness (for example customs clearance, product inspection procedures, port tariffs and operations).

iii) Simplification of Regulations and Procedures

If companies need to expand or develop a production site, there must be clear and standardised system that the company has to go through.

The programme could support:

- Review of the system of developing, modernising or expanding industrial sites.
- Ensure that local planning authorities understand the importance of developing businesses focussed upon the local and national economy, and community.

iv) Support silvicultural production/development

If the tree nurseries had suitable equipment and better techniques, they would be able to produce a better product with greater efficiency. This is often regarded as non-profitable part of forestry management due to the high labour requirement and limited market scope.

The programme could support:

- Focused education and training
- Support in the development of the modern silvicultural facilities
- Suitable planting equipment
- Possible privatisation of the activities

v) Ensure companies operate with transparency

Presently transparency is not high within the forest industries. This leads to a “knock on effect” in other sectors of industry. It also leads to transparent companies often working at disadvantage;

The programme could support:

- Enhanced audit programmes for the companies
- Development of positive support mechanisms for foreign investment that complement the National Development priorities and do not detract from future competitive advantage

vii) Private Forest Integration

Currently the sector has a large number of relatively small private forest owners (constitutes approximately 45% of all forests). These holdings are very fragmented and are characterised as ‘not being very co-operative’. Advisory assistance will need to be provided to appraise the options for a revision of ownership, activities and inter-relationships in order to integrate these forests in the programmes discussed earlier.

The development of an integration within the smaller forestry owners is crucial as it will support the other measures outlined and also encourage other activities to get higher value added from their forests.

Eligibility Criteria

- All investment projects will contribute to the NDP SM priorities;
- Adequate co-financing is provided from state and municipal budgets;
- For physical infrastructure, concrete linked investments by private enterprise must exist;
- Private enterprise investments must have commitments for the necessary capital or other finance;
- Be determined to contribute to competitive advantage development in appraisal and feasibility studies;

- Contribution to competitive advantage demonstrated, commensurate with the investment required by the State and providing amortisation over an appropriate time-scale;
- Infrastructure investments must be fully appraised and feasibility established.

2) **Human Resources Development.**

Education and Research

Greater emphasis must be placed upon education and training and research focused towards current and future industry needs.

The programme could support areas such as:

- Encouraging greater interaction between the industrial sector and the state institutions;
- Supporting the development of training programs that are linked to industrial development;
- Development of low cost industrial training on EU standards and quality control, ensuring that the industry fully adopts CE marks and ISO regulations.

One of the proposed 'Milestone project' idea to be financed out of the Phare 2001 ESC Programme is **"Baltic Pulp"** project, which is foreseen to be one of the largest investment projects in the forestry sector for time being.

Currently there is no vocational school functioning in Latvia could deliver specialists of appropriate profile that would correspond to particularity to the needs of the proposed pulp-mill project. For this project alone it is calculated that there will be a need for training of 100 people in the first year and 25 – 30 annually. The planned socio-economic impact study (LE 9805.01/0001) will support identification of wood pulp specific and other cluster needs.

This intervention has led to the elaboration and implementation of several new qualifications at Qualification level, 2 and 3 (according to the law of Vocational Education and Training), curriculum development, foreign expertise, teacher training, development and production of training materials, purchase of training equipment, management of the new education design up to the opening of the school to take in first students. The school needs to be established in the year 2002. It is proposed partial funding of this project could be a subject for Phare ESC 2001 programme and the funding could comprise – 1 MEUR. Financing will be provided also from the municipalities and Ministry of Education

On a broader scale, the above components can lead to a pipeline of projects for future financing from Phare ESC 2001 – 2005 to improve the quality of education and training in the forest cluster.

Building the Knowledge Economy

Real economic convergence is conditional on an adequate stock of human capital. Assessing the quantitative impact of human capital on growth is not easy although studies show that the social returns to investment in human resources is high.

Based upon the objective of convergence with the wider European Union and the process of job destruction and job creation that are an integral part of the process of structural change to attain future competitive advantage, in Latvia the importance of the labour market in terms of competitive supply and demand of skills cannot be understated. The ICT revolution has already radically changed the working environment. Education and training must keep pace with continuing technological developments and pre-empt future demands for innovation within a broader European and Global context.

Present Situation

There are mixed views about the quality of the stock of human capital in Latvia and the performance of education policy. At a certain level Latvia is well endowed with human capital and school enrolment rates are high. Over 80% of the labour force has an upper-secondary-education level or more which is higher than the average for EU countries. Moreover, Groups with better qualifications perform better than other groups in terms of labour force participation and unemployment. The standard view is the Latvia has a well-educated workforce and that this augurs well for future development

Labour Force Participation

	Labour Force Participation Aged 15 or more	Unemployment
Primary or less	16	23
Lower Secondary	35	20
Upper Secondary	71	15
Tertiary	79	7
Average	59	15

Source: Labour Force Surveys, second quarter 1998.

An alternative view is that much of the education provided is not suited to the needs of a market economy. This is certainly revealed by surveys of foreign investors. Regarding the quality of professional/practical training only 10% of foreign firms believe that it is good with over 35% stating it is unsatisfactory. Regarding management/administrative training the figures are 6% and 48% respectively. Local companies have a more positive view while theoretical/academic training and computer/IT training were considered to be the best. Generally it seems that the type of flexibility desired by foreign companies does not exist and that employees do not possess the mix of skills required. There is a need to retrain through increased vocational and on the job training while improving the education system.

Latvia spends a high proportion of its available resources on education. The pupil-teacher ratio is also lower but this reflects the fact that there are a large number of rural schools. Teachers' pay, as a share of total education expenditure, is low. This is leading to a brain drain from the teaching profession and needs to be addressed as it affects the quality of the next generation of teachers as well as its current stock. A range of improvements is required in terms of teacher training, new curricula and assessing performance and results. The key challenge is to equip those leaving the system with the basic skills required to begin a career of lifelong learning. The education system also faces a challenge from the projected fall in the school-age population.

Education policy is only one element of human resource policy. There is also an important role for training and active labour market initiatives. The prospective restructuring of industry and the effects of technological change will shift the relative demand for different types of labour over time. Policies will have to continually re-train and re-skill unemployed worker to keep them in touch with the labour market. This will ensure that they exert appropriate pressure on wages through the standard Phillips curve effect in order to support competitiveness. This is a major challenge for active labour market policies particularly given the level of structural unemployment and the regional disparities in unemployment.

Currently education and the structure of training and labour market initiatives have generally a domestic, internal competitiveness. This has resulted in fragmented developments not synchronised on a national / regional basis in order to establish future competitive advantages for the country as a whole, in the European or Global environment.

Future Needs

Globalisation trends highlight the crucial role of education and knowledge in today's world. The nature of work is changing. Knowledge is now a key element of economic and social development. A skilled and flexible labour force is the key factor affecting comparative advantage whereas in the past location and the availability of raw materials were paramount. Moving Latvia from a low added-valued economy to one relying on modern technologies requires a considerable upgrading of skills through improved basic education and life-long learning. This will build on the potential advantages from the high level of school enrolment rate.

The roles and activities of educational institutions within economies have changed substantially when viewed globally. New structures of fund raising have developed, the role of research and the linkages to global and domestic industries have grown in volume and are highly sophisticated. The provision of services by educational institutions in both their domestic and the global economies are linked to both fund raising and to curricula components, and have become similarly complex. Different training institutions operate in a competitive environment in a global market, and to succeed must offer a recognised, modern, internationally competitive product, and be capable of competing in the global market for students and high quality teaching staffs.

Potential Projects

As detailed in the fiche, development of specific projects will be undertaken with the current Phare Project Preparation Support (PPS) (LE 99.14) and Components 1 and 2, with focus upon NDP (SM) goals. It is therefore inappropriate to present specific detailed projects at this time.

The following strategic components could be included in Milestone Projects linked to the Building of Knowledge Economy:

1. Human Resource Development

The following contributing elements have been identified as components for further elaboration of the Milestone Project concept under the PPF:

- Identification of domestic and international needs;
- Elaboration of anticipated future skill set needs and foresight development;
- Modernise the contractual framework of working life to accommodate flexibility and security;
- Curriculum development, co-ordination, and recognition;
- Targeted vocational training development, structures, and recognition
- Innovation;
- Up-grading of organisation and facilities;
- Creation of a network of Science Technology and Industrial Service Parks;
- Broadening student catchment area;
- Support enterprise foresight development to minimise economic change to enhance planning of employment requirement
- Develop imaginative policies negotiated with social partners including all economic, institutional and social actors
- Develop temporary employment placements for practical skills experience (amongst other measures)
- Encourage further integration of women in the labour market through training and information support

This component is by its nature supply side orientated and is significantly aimed at the creation of skills sets to pre-empt future demand - which may today be unrecognised within the labour market. These will be better defined in the process of development of the detailed Eligibility and Selection Criteria. Broad input from institutions, industry and social partners and existing projects will be sought to extend and affirm the perceived needs and establish priorities.

2. Infrastructure

Latvian Science and Technology and Industrial Park Network

The overall objective is to create a parks network on a nationally co-ordinated basis as part of a highly specific educational and training programme, where the parks would be located in existing or new optimal locations in regions on a complementary basis. Such parks could encompass a campus of technical and natural sciences faculties of the Latvian universities, Research and Development institutions, spin-off companies and support companies (SME's). Additionally there exists the potential for linked suitable and affordable accommodation. This could stimulate University - enterprise partnerships (both domestic and international) assist in the development of highly qualified scientific staff and encourage young researchers.

The number, location, linkages and focus of such parks must avoid domestic competition. It offers an additional key element in the management of the assets of the Latvian Universities. It will contribute to building a 'new University' capable of competing internationally, which can be the vanguard of economic development with enhanced potential for raising money, undertaking innovative activity and creating jobs. This will contribute to the creation of specific attributes of Latvia upon entry into the EU.

It is envisaged that in the PPS and linked to each of the components, an appraisal and feasibility is required to identify priority number, location, linkages and focus of such parks in synchronisation with the elements described above.

a) Science and Technology Parks.

Currently a science and technology park in Riga is planned. As a part of the park there would be a campus of technical and natural sciences faculties of the universities, R&D institutions, spin-off companies (SMEs) and this potential would allow to attract and to locate at the same campus also medium size high-tech companies (100 – 200 employees) benefiting and using the educated labour force. Improvement of the quality of education in high-tech sectors (e.g. ICT, biotech, new materials etc.) and increase in numbers of students in those sectors is essential part of the project.

The concept of the project was based on analysis of the experience of other countries (Sweden, Finland, France, UK, Ireland, Hungary) as well as on long term development vision of Latvia Concept of Sustainable Development "Latvia: from Vision to Action" by a group of leading economists in 2000.

The implementation of the project would bring together elements, necessary to form a nucleus of critical mass for sustainable development of high-tech research and industrial sector in Latvia. Some of those elements already do exist in Latvia – universities (such as the faculties of natural sciences and technical sciences of the Latvian University and Riga Technical University), related scientific research institutes, companies active in high-tech sectors, spin-off companies and incubators (Latvian Technology Centre and Latvian Technology Park).

The experience of similar developments in the EU countries, particularly with the effective development of clusters, shows, that the contribution of universities, research and development institutions and industrial companies based on innovations and high-tech products is absolutely essential. It supports a synergy between them, by creating economic development opportunities involving researchers, students and the university as well as domestic and international enterprises.

Development of a Science and Technology Park is a complicated and long-term project for the term of 5 – 10 years. Such a long term is determined by a very large size of the project in the range between 100 – 200 MEUR. A Feasibility Study on development of Riga Science and Technology Park (PPS LE 9914) is currently planned.

However this needs to be further integrated with all the Programme Components, as an appraisal and feasibility is required to identify priority number, location, linkages and focus and optimal locations of a limited number of such parks. During the appraisal and feasibility study much work has to be done to agree opinions of all the stakeholders, and to secure political support for such a Science, Technology and Industrial Service Parks Network project.

The study should select location alternatives (today there exist at least 4 potential sites, which are considered by the Latvian University as potential campus, two suitable for large size S&T Park (one 40 ha, another 600 ha), two other for smaller size medium term solution). Cost-benefit analysis should be undertaken to justify the investment and to verify the optimal location, whether in the environs of a 'Greater Riga', elsewhere in the country or on an integrated programmed national basis, with partial or full relocation of the three universities currently in Riga.

b) Industrial and Services Parks

Industrial and service parks offer an contributor on localised basis with shared facilities and infrastructure and the potential to maximise the effect and accelerate the amortisation of the investments made. Investment offers the potential to complement other job generation actions in the Region and to consolidate investments of the private sector. It is however important that supported projects should satisfy eligibility and selection criteria that reflect both a contribution

to national competitive advantage, complementing investment by the private sector where projects of national significance have attracted committed investors.

A number of indicative but not fully developed projects within the Latgale region, in the Daugavpils, Rēzekne, Jekabpils district centres, in some other centres such as Līvāni, and at the Karosta Industrial Park (KIP), in Liepāja, Cyber City in Valmiera, Zemgale IT Region project have been identified as potential projects. There exists the potential to establish a nationally linked and integrated network of science, technology and industrial / service parks, at least in terms of planning and appraisal and in this regard the study detailed above (a) should include the appraisal of the needs and optimal location for such network(s) and linkages.

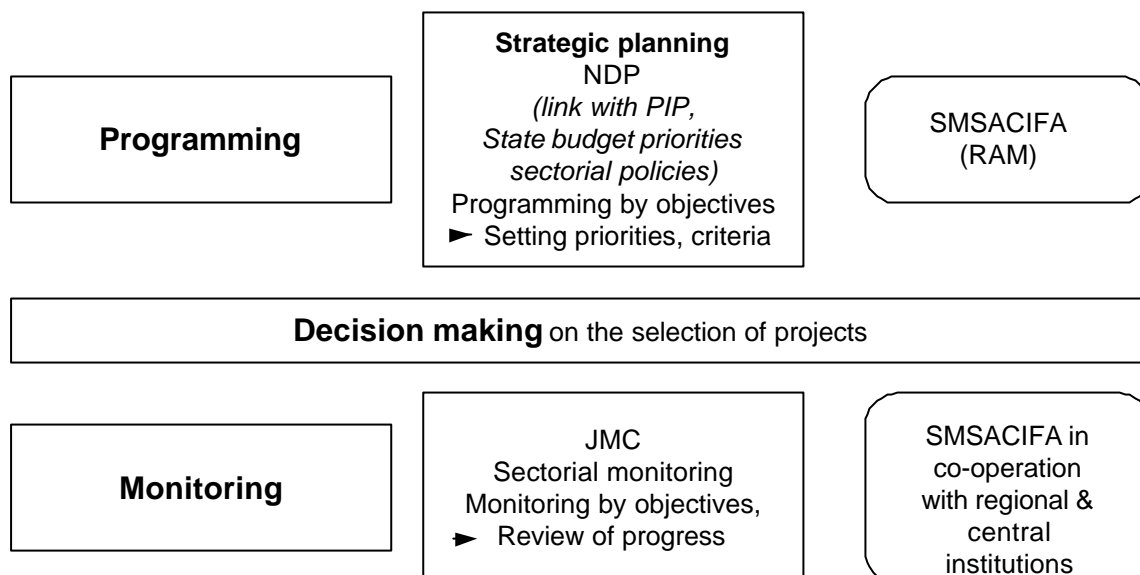
This component is to be demand orientated and is significantly aimed at the creation of industrial / service parks that can satisfy current short term demand and leverage on private sector funding for nationally significant projects. Broad input from institutions, industry and social partners and existing projects will be sought to extend and affirm the perceived needs and establish priorities.

Eligibility Criteria

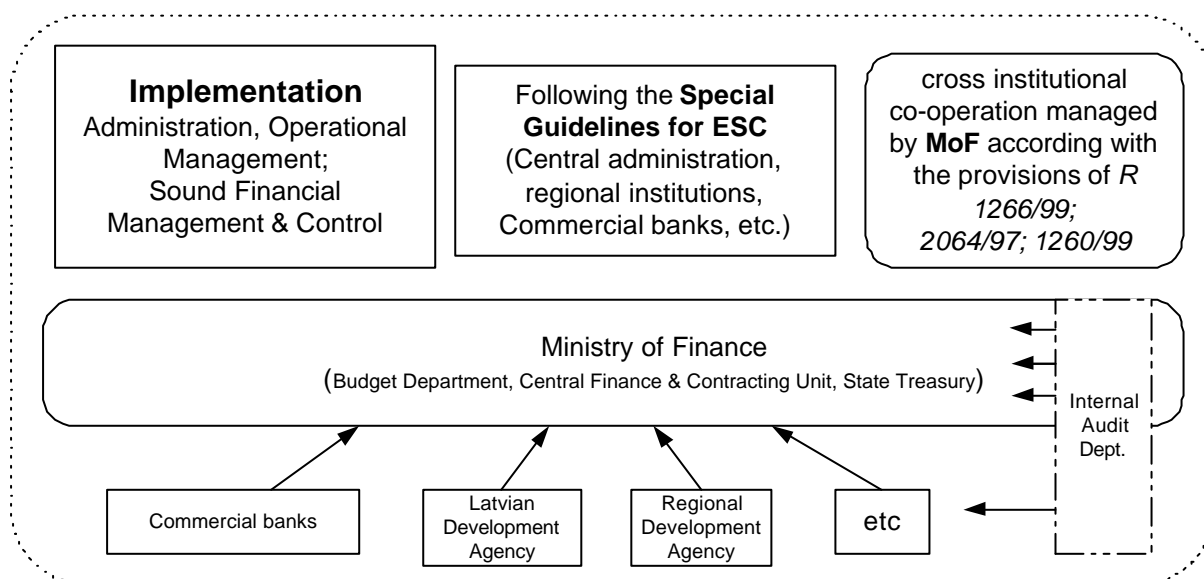
- All investment projects will contribute to the NDP SM priorities;
- Adequate co-financing is provided from state and municipal budgets;
- Concrete linked investments by private enterprise exist;
- Private enterprise investments must have commitments for the necessary capital or other finance;
- Be determined to contribute to competitive advantage development in appraisal and feasibility studies;
- Contribution to competitive advantage demonstrated, commensurate with the investment required by the State and providing amortisation over an appropriate time-scale;
- Infrastructure investments must be fully appraised and feasibility established.

ESC Implementation Scheme

Strategic management



Operational management & control



Assumptions:

- 1) based on R 1266/99 & 438/01 (strong PIFC within MoF - IAD), i .e. *EDIS* applicable
- 2) management & control system for both EU & national funds
- 3) based on segregation of duties between approval, procurement, authorisation to pay, payment
- 4) based on efficient accounting & financial reporting system