SUPPLEMENTAL MEMORANDUM OF UNDERSTANDING

(Fourth addendum to the Memorandum of Understanding)

BETWEEN

THE EUROPEAN UNION

AND

THE REPUBLIC OF LATVIA

SUPPLEMENTAL MEMORANDUM OF UNDERSTANDING
(Fourth addendum to the Memorandum of Understanding)

between the European Union and the Republic of Latvia

1. **On 20 January 2009 the Council of the European Union (EU) adopted a Decision (2009/290)[1] to make available to Latvia medium-term financial assistance of up to EUR 3.1 billion.** This financial assistance shall be made available during three years starting from the first day after the entry into force of the Council Decision, with a maximum average maturity of seven years. The EU assistance should be provided in conjunction with a loan from the International Monetary Fund of SDR 1.5 billion (1200% of Latvia's IMF quota, around EUR 1.7 billion) under an IMF Stand-by arrangement approved on 23 December 2008. The Nordic countries (Sweden, Denmark, Finland, Norway and Estonia) are to contribute EUR 1.9 billion together, the World Bank - EUR 0.4 billion, the European Bank of Reconstruction and Development, the Czech Republic and Poland - a total of EUR 0.4 billion, bringing the total to EUR 7.5 billion over the period to the last quarter of 2011.

2. **The EU financial assistance is provided in support of the Latvian authorities' Economic Stabilization and Growth Programme** ("Programme") – most recently updated in the form of the Convergence and National Reform programmes submitted to the EC on 30 April - to maintain domestic and international confidence in the financial system, address the budgetary imbalances, contribute directly and indirectly to improving competitiveness, and strengthen the economy's growth potential by a range of structural reforms. Implementation of the measures proposed in the Programme would help to lay the groundwork for sustainable convergence and Latvia's goal of entry to the euro area.

3. **The EU financial assistance will be disbursed in six instalments.** The amount of the first instalment was EUR 1 billion, released on 25 February 2009 after signature of the Memorandum of Understanding ("the Memorandum"), while a second instalment of EUR 1.2 billion was released on 27 July 2009 after completion of the first review mission and the broad fulfilment of the economic policy criteria laid down in the Memorandum. The third and fourth instalments of EUR 0.5 and EUR 0.2 billion were released on 11 March 2010 and 21 October 2010, respectively, following completion of the second and third review missions, and broad fulfilment of the economic policy criteria, as laid down in the first and second Supplemental Memoranda of Understanding. **The fifth instalment, of EUR 0.1 billion, if requested, shall be released subject to the signature of this fourth Supplemental Memorandum of Understanding.**

4. **The Commission services carried out the fourth review mission in cooperation with the IMF staff from 5 - 15 April 2011** to assess progress made with respect to the specific conditions attached to the fifth instalment of the EU financial assistance, as laid down in the third Supplemental Memorandum of Understanding. Based on the findings of the mission, a Compliance Note sent by the authorities on 1 April 2011 and the consultation of the Economic and Financial Committee on 1 June 2011, the specific economic policy criteria were considered to be broadly fulfilled. Since the previous review mission, further budgetary and structural measures, supported by an improved macroeconomic outlook

[1] Amended by Council Decision 2009/592

(the economy bottomed out in 2010 and GDP is expected to expand by 3.3% in 2011 and 4% in 2012), ensured compliance with the policy programme. In particular, this conclusion reflects:

a) **Achievement of the 2010 budget target of 8.5 % of GDP in ESA95 terms**: the fiscal deficit was 7.7% of GDP, or, excluding bank restructuring costs, 5.5% of GDP.

b) **Parliament adopted the 2011 budget on 21 December 2010 and a supplementary 2011 budget on 14 April** with total measures amounting to around LVL 370 million (full year impact, though not all of these will yield permanent savings), with the aim to achieve a deficit target of well below 6% of GDP. Measures in the 2011 budget include, on the revenue side, (i) an increase in both the standard and reduced VAT rates and reduction of categories for which the reduced VAT regime applies; (ii) higher employees social security contributions; (iii) increased taxation of private vehicles and privately used company cars; (iv) introducing a financial stability duty and a fee for non-bank companies providing consumer loan services; (v) doubling real estate taxes; and (vi) increased excise duties and reduced duty-free allowances on certain products. Some measures – like increased dividend payout ratios for many state-owned enterprises and a reduction in pension contributions diverted to the second pillar – are, however, unlikely to lead to permanent reduction in the deficit. The expenditure side measures include (i) reduced staff and wage costs in the public administration; (ii) reduced appropriations relative to previous year's level in a number of areas, including health spending, social programs, and defense spending; (iii) reduced subsidies for general education and financing for education innovation programs; and (iv) cut in railway subsidies.

c) **Progress is being made in identifying main areas and key measures to ensure 2012 budget consolidation.**

d) **Progress is being made as concerns the strengthening of the fiscal framework**. The authorities continue working on the draft fiscal responsibility law and respective amendments to the constitution; the latter aim to ensure that provisions of the fiscal responsibility law have greater legal standing than other laws. While the authorities have prepared an exhaustive list of state-owned enterprises, the strategy for more efficient management of state owned assets has not been submitted on time.

e) **Progress is being made with strengthening tax administration and combating the grey economy**. In 2011 budget and supplementary budget the authorities have introduced: (i) measures to speed payment of tax arrears; (ii) an increase in the minimum wage, which should limit the underreporting of wages; (iii) steps to combat smuggling of goods; and (iv) an approach to improve cooperation with sectoral business associations. While battling the grey economy is an important component of the fiscal adjustment strategy, the revenue yield is uncertain and hard to quantify. In order to assess effectiveness of various measures, the authorities intend to set up a task force involving the program partners, with the aim to report on expected yields in 2012 and beyond by mid-August 2011. The authorities also intend to revise the tax compliance strategy, taking into account the recommendations of an upcoming technical assistance mission from the IMF.

f) **Significant financial system stabilisation measures have been taken**, including on management of large exposures, remuneration policies, stress testing guidelines and reinforced supervisory anti-crisis management. Cooperation continues with neighbouring countries and relevant foreign supervisors. The restructuring process of the Parex Bank and Citadele is well advanced. Adoption of the transformation plan of the Mortgage and Land Bank by the Cabinet of Ministers, significantly delayed, has taken place on 12 April 2011.

g) **There has been good progress in addressing structural reforms,** in particular as regards improving absorption of EU funds, amending public procurement procedures, streamlining efforts to attract new FDI and making operational the special program for the support of small and micro companies.

5. Conditions for the next instalment, if requested, relate to consolidating the gains made thus far while setting the stage for stable public finances and sustained growth. The fulfilment of the conditions will be assessed at the next Review expected on or after (15) November 2011.

a) **Concerning budgetary consolidation,** the Latvian authorities are committed to achieving a 2011 deficit target of no more than 6% percent of GDP and a fiscal deficit of below 3 % of GDP in ESA95 terms in 2012 in line with the ECOFIN Council EDP recommendations. Aiming for a 2.5% of GDP deficit in 2012 will demonstrate the Latvian authorities' commitment to fiscal discipline and debt sustainability, and to meeting the Maastricht criteria on a sustainable basis. Building on the overachievement of previous and current fiscal targets, preliminary estimates suggest that achieving this target will require a further LVL 150-180 million (1.1% to 1.3% of GDP) in net additional measures, well below previous estimates. Preparatory work is underway to identify a menu of options for measures to be included in the 2012 budget. Preparing such a menu of options by mid-August 2011 will give the authorities a meaningful choice of measures once the final consolidation needs are assessed by end-August 2011 and will enable the government to submit by end-September 2011 a budget for Parliamentary approval.

b) **To improve revenue collection**, the authorities are working on proposals to reform the property tax system, and to implement a comprehensive strategy to strengthen tax administration and reduce the grey economy. The authorities are also working to reallocate personal income taxes paid to local governments to the state budget. Additional revenue may be generated by better SOE and real estate management.

c) **As regards expenditure cuts**, the authorities are considering reducing the public sector wage bill and state subsidies, and reviewing options for rationalizing the system of social benefits and improving the sustainability of the pension system that is consistent with the long-term stability of the social security system, building, inter alia, on the recommendations of the World Bank public expenditure review and IMF technical assistance. The State Chancellery is undertaking functional audits to identify functions that can be abolished or performed more efficiently.

d) **The authorities are also considering options to ensure the long-run sustainability of social security.** The authorities have completed a concept paper on social security that will form the basis for a comprehensive pension reform to be introduced in the context of the 2012 budget. The authorities are committed to preserving the sustainability of the three pillars of the pension system and to restoring contributions to the second pillar to 6% of gross salaries by 2013, provided that the budgetary situation improves in line with the current forecast.

e) **In other areas of the programme**, the authorities intend to agree with the Commission and the IMF on the substance of the draft fiscal responsibility law by end-August 2011 and to submit the draft law(s) to Parliament by end-November 2011. They also intend to prepare the draft medium-term budget framework law, to be submitted to Parliament by mid-2012, that will introduce binding multi-year expenditure ceilings, a prohibition on raising within-year appropriations due to over-performing revenue, and limitations on the introduction of expansionary fiscal measures after adoption of the budget. Measures are to be taken to promote growth and jobs through competitiveness, efficiency and measures countering inflationary pressures in a sustainable manner, including improving management and performance of the public administration, accelerating EU fund absorption, strengthening public procurement and competition, supporting active labour market and lifelong learning policies, improving the business environment and supporting export promotion measures.

6. **The specific economic policy criteria attached to the next instalments of the financial assistance and the reporting requirements are laid out in Annex I and Annex II**, respectively, to this Supplemental Memorandum of Understanding, which is the fourth addendum to the original Memorandum. The Annexes form an integral part of this Supplemental Memorandum and replace previous Annexes.

7. **The outlook regarding external financing suggests that international medium-term financial assistance envisaged in the programme is sufficient** and there may even be no need to draw from some of the loans by international or bilateral lenders. The improved economic and financial situation is creating favourable conditions for the central government to gradually return to international capital markets under reasonable terms.

8. **Given the overall stabilisation of the financial system reducing potential banking sector funding needs, money currently in the sub-account for banking sector support at the Bank of Latvia can be released for the purpose of financing general government needs,** following formal approval by the Commission upon a request by the Finance Minister, and in accordance with the following schedule, whereby progress is to be assessed by the Commission and IMF:

   - EUR 300 million, on the basis of the submission to the Commission of the transformation plan for MLB in April 2011 and of the adoption of the sale strategy for Citadele and workout strategy for Parex in May 2011.

   - EUR 100 million, on the basis of submission to the Commission of the sale strategy for MLB commercial segment.

   - The remaining EUR 249 million, on the basis of progress with the sale of Citadele and of the commercial assets and liabilities of MLB.

9. **The effective payment of the Loan instalments is subject to the corresponding legal commitment (Loan Agreement) signed in January 2009.** The disbursement date of each loan instalment or tranche will be agreed by the two parties in accordance with the Loan Agreement. In this regard, given improved economic situation and strong financial position, the authorities have indicated that the funds available at this review would not be drawn, except for the EUR 100 million expected to be approved by the World Bank. If this were to change, the disbursement request for the fifth instalment of up to EUR 0.1 billion shall be transmitted by the Latvian authorities to the Commission until 15 June 2011, or

the sixth instalment (to be released before 19 January 2012) will be increased by the corresponding amount.

10. **Prior to the release of each instalment, the EFC shall be kept informed by the Commission of the fulfilment of the conditionality attached to the instalment in question.** The authorities will ensure, as appropriate, close co-operation with the EFC.

11. **Upon expiration of the assistance, Latvia will be subject to Post Programme Surveillance, being managed by the Commission as an integral part of the existing procedures and surveillance mechanisms.** This is in accordance with the established EU procedure for providing financial assistance for non-euro area EU Member States. Upon expiry of the programme and until repayment of a large fraction of the EU loans, Latvia will continue to provide the Commission with information similar to that required during the programme, including prior information on major policy intentions. Post-programme surveillance missions will be aligned with regular surveillance missions (also from the IMF) to avoid duplications and ensure efficient use of resources. The frequency of missions will be determined by the Commission, after consultation of the EFC, depending on programme modalities, payback schedules and an assessment of residual policy and economic risks, also taking into account the standard surveillance. Close cooperation with the IMF will be ensured also in the post-programme period and staff from the ECB will be invited to participate in the missions.

12. **The European Central Bank will act as an agent to the Commission** and shall transfer the proceeds of the Loan instalments or tranches to a euro account of the Ministry of Finance (the Treasury) held at the Bank of Latvia ("the Agent").

13. **During the implementation of the assistance, the authorities shall make available to the Commission all the relevant information for the assessment of progress in economic conditions and reform measures** as specified in Annex I. Prior to the release of subsequent instalments by the Commission, the authorities shall provide the Commission with Compliance Statements on the fulfilment of the conditionality attached to the instalment.

14. **Investigation and satisfactory treatment of any suspected and actual cases of fraud, corruption or any other illegal activity** in relation to the management of the EU Balance of Payments assistance shall be ensured. All such cases as well as measures related thereto taken by national competent authorities shall be reported to the Commission without delay.

15. **The European Court of Auditors shall have the right to carry out financial controls or audits that it considers necessary in relation to the management of this assistance.** The Commission, including the European Anti-Fraud Office, shall have the right to send its own agents or duly authorised representatives to carry out technical or financial controls or audits that it considers necessary in relation to the management of this assistance as long as the Loan has not been fully repaid.

16. **An independent ex-post evaluation of the assistance may be carried out by the Commission or its duly authorised representatives.** The authorities are committed to

supply relevant information for the evaluation. The draft evaluation report will be made available to them for comments.

17. All notices in relation with the present Supplemental Memorandum shall validly be given if in writing and sent to:

For the European Union
European Commission, DG for Economic and Financial Affairs
B-1049 Brussels, Fax No.: (+32-2) 296.48.85

For the Prime Minister
State Chancellery
Brīvības blv. 36, Rīga, LV-1520, Fax No.: (+37 1) 67 28 04 69

For the Ministry of Finance of Latvia
Ministry of Finance of Latvia
Smilšu iela 1, Rīga LV-1919, Fax No.: (+37 1) 67 09 55 03

For the Bank of Latvia
Bank of Latvia
K.Valdemāra 2A, Rīga LV-1050, Fax No.: (+37 1) 67 02 24 20

For Financial and Capital Market Commission
Financial and Capital Market Commission
Kungu iela 1, Rīga, LV-1050, Fax No.: (+37 1) 67 22 57 55

18. For Latvia, this Supplemental Memorandum shall become effective after completion of internal procedures required under the Laws of Latvia. The Supplemental Memorandum may be amended upon mutual agreement of the parties in the form of an Addendum. Any such Addendum will be an integral part of the Memorandum and become effective according to the same procedures as the Memorandum.

Done in Brussels on 7/6/2011 and in Riga on 3/6/2011 in five originals in the English language.

LATVIA	**EUROPEAN UNION**
Represented by	Represented by EUROPEAN COMMISSION
Valdis Dombrovskis The Prime Minister	*Olli Rehn* Member of the European Commission
Andris Vilks Minister of Finance	
Ilmārs Rimšēvičs Governor of the Bank of Latvia For the responsibilities of BoL	
Irēna Krūmane Chairwoman of the Financial and Capital Market Commission	

A. Bambale
Latvijas Bankas
Starptautisko attiecību
un komunikācijas pārvaldes
vadītāja vietniece,
Starptautisko attiecību un
protokola daļas vadītāja
02.

ANNEX 1

SPECIFIC ECONOMIC POLICY CRITERIA

1. General Programme Conditions

a) The general government budget deficit targets for 2011 and 2012 in ESA95 terms are set at no more than 6% and below 3% of GDP, respectively.

b) All significant Cabinet decisions or other decisions with a fiscal impact, including on social security or any guarantee scheme, shall be announced and undertaken only after discussions with the EC and the IMF.

c) Any additional revenue or savings achieved relative to deficit targets should be used to achieve a lower-than-targeted budget deficit or, after consultation with the EC and IMF, to accelerate EU funds expenditure within the budgetary deficit targets set above or increase funding for active labour market and social safety net measures. EU budgetary funding related to Structural funds and Cohesion Fund shall be used to the full extent and be budgeted appropriately. Appropriate resources, including technical assistance, shall be ensured for the management and implementation of EU funds and other foreign financial assistance, and allocated to the respective Managing Authority, Audit Authority, Certifying Authority and the Intermediate Bodies and the Procurement Monitoring Bureau.

d) The Ministry of Finance's macroeconomic forecasts used as a basis for the budget preparation should be reviewed by the Bank of Latvia in consultation with external experts. The Commission services' forecast should be taken as a benchmark.

A: Fiscal consolidation and fiscal governance reforms

2. To ensure fiscal discipline:

a) by mid-August 2011, identify a menu of options for deficit-reducing measures to be included in the 2012 budget, so as to enable the government to submit a budget for Parliamentary approval by end-September 2011.

b) by end-August 2011, agree on the substance of a draft of the Fiscal Responsibility Law with the Commission and the IMF in view of submitting the draft law(s) to Parliament by end-November 2011; by end-November 2011, submit a constitutional amendment to Parliament to ensure that the provisions in the Fiscal Responsibility Law have greater legal standing than other laws.

c) by end-September 2011, evaluate the efficiency and effectiveness of existing taxation allowances (notably for CIT and PIT) with a view to better target or repeal those that have not attained the objectives and improving consistency across taxpayers, while possibly considering other types of policy support.

3. To fight grey economy and tackle illicit trade:

a) continue implementing key measures of the adopted strategy for fighting the grey economy, notably the new declaration scheme, and measures to speed up payment of tax arrears, with actions to be completed by 1 January 2012 at the latest; in this context, by end-September 2011, evaluate the possibility to suspend payments by the Treasury to companies until arrears are settled or off-set.

b) by end-September 2011, to foster closer cooperation between the State Revenue Service and entrepreneurs, publish and make operational the "white list" of companies and continue expanding the bi-lateral cooperation agreements between the State Revenue Service and sectoral associations.

c) by end-September 2011, review sanctions for illicit and abusive trade and strengthen capacities of controlling institutions.

4. To ensure adequate financing for social needs and a transparent and cost-efficient delivery of social assistance:

a) by end-August 2011, submit to international lenders proposals for the reform of scope and financing of a comprehensive and targeted social safety net program for 2012 and beyond, taking account of cost efficiency and fiscal implications.

b) by end-September 2011, implement the State Audit Office recommendations as regards necessary improvements in the administration of Social Safety Net Strategy, including setting-up a centralized social assistance register.

B: Financial sector measures

5. By mid-May 2011, in consultation with the Commission and IMF, appoint a senior government official to take charge of the Mortgage and Land Bank restructuring process and hire a qualified, experienced, and independent sales consultant mobilizing a team of internationally reputable experts to prepare and run the sales strategy; by end-June 2011, the sales consultant shall prepare and, after consulting the government, submit to the Commission a sales strategy for the commercial segment of MLB, in order to allow the actual sales process to start in July 2011 and complete it by mid-December 2011; to oversee the restructuring and sales processes, appoint by end-June 2011 a qualified and independent head of restructuring with international experience, who will report to MLB's supervisory council.

6. Implement the sales and work-out strategies for Citadele Bank and Parex Bank, as approved by the Cabinet of Ministers on 17 May 2011.

7. By end-October 2011, based on external consultant's recommendations, prepare an action plan for optimization of the system of development financial institutions and integration, as appropriate, of different development institutions operating on behalf of the government; looking ahead, development institutions shall limit direct lending, except where concessional programs are already approved, or in instances where the lending is: (i) associated with the delivery of products not offered by the commercial banking sector; (ii) dependent on highly specialized knowledge that commercial banks do not possess: or (iii) of too small volume or too risky to be of interest to commercial banks; in this context, prepare an exit strategy plan for EIF Holding Fund to be submitted to the Commission by end-October 2011.

8. Continue strengthening the incentives for market-based debt restructuring; in this context; by end-September 2011, in consultation with relevant sector experts, make necessary steps to further increase transparency and regulated access of financial sector actors to wider information on individuals' solvency situation.

C: Structural issues and reforms

9. To ensure adequate, efficient and transparent management and implementation of EU funds:

a) allocate sufficient budgetary resources for EU funded support, and demonstrate the achievement of expenditure levels paid by the intermediate bodies. As a minimum, in 2011 Latvia should target annual expenditure (paid by the intermediate bodies) of at least 72 million EUR from the European Social Fund, 201 million EUR from the Cohesion Fund and 318 million EUR from the European Regional Development Fund. In addition, ensure that the level of incurred expenditure for real implementation of projects on the ground (i.e. excluding advances and payments to financial engineering instruments) paid by the intermediate bodies from the beginning of the programming period is not less than EUR 1,052 million in total from the European Social Fund, the Cohesion Fund and the European Regional Development Fund.

b) by end-December 2011, take significant steps to improve the quality of evaluations to assess how the EU funds support is contributing to the achievement of expected results and to use the evaluation results for optimizing the planning of the 2014-2020 period. In addition, medium-term prospects for centralising administration of EU Funds projects, as a possible way to reduce administrative burdens, avoid overlapping functions and unify standards of interaction with beneficiaries, are to be assessed.

c) by end-July 2011, take action to reallocate funds away from activities, which did not have Cabinet Regulations approved by the end of 2010 (as required by the Law on EU Structural Funds and Cohesion Fund Management).

d) by end-December 2011, sign all contracts related to the first call for tender within the ERDF activity "Development of Research Infrastructure" in view of starting projects' implementation by end-2011, and by June 2012, sign all contracts related to the second call for tender; take action to ensure that the incurred expenditure by the intermediate body from ERDF for the activity reaches at least EUR 20 million in 2011, EUR 30 million in 2012 and EUR 65 million in 2013; on a broader level, take action to achieve the national targets for R&D expenditure as stipulated in the Latvian Strategic Development Plan for 2010-2013.

e) create conditions for independent experts - to be recruited with JASPERS assistance by end-June 2011 - to assess the possible quality problems of recent road and bridge reconstructions and the system and procedures for quality monitoring and control of construction works in order to provide by end-2011 recommendations on improvements in these areas (including safety audit procedures), and on increasing standard warranty periods for road projects.

f) by end-September 2011, ensure conformity of national financial engineering instruments' operations (loans and guarantees) with the appropriate EU regulations and the received guidance from DG REGIO services, and make further steps to increase significantly their leverage (i.e., private total contribution to the investment associated with the loans and guarantees) and multiplier ratio.

10. To improve management and performance of human resources and decision-making in the public administration:

a) by end-June 2011, prepare an action plan for further centralizing management and planning of human resources within the public administration and establishing clear links between career development and annual assessment based on competences and performance and start implementation latest by end-2011.

b) by end-August 2011, the State Chancellery shall identify administrative decisions, currently taken by the Cabinet of Ministers, which could be adopted by delegation to either individual ministers or senior public officials.

11. To promote more efficient use of energy and natural resources:

a) by end-2011, further progress should be made through full transposition of the energy-related EU legislation, with a focus on the applicable elements of the Third Package, and, in particular, increasing the independence of the national regulator and the competition council, including the financial independence, and promoting more competition in the energy sector.

b) by end-July 2011, submit to the Parliament the necessary draft legislation to implement the National Renewable Energy Action Plan, including a review of the existing renewable energy support mechanism.

c) by January-2012, apply new rates of the natural resource tax law for extraction of natural resources, waste land-filling and air pollution as provided in the Natural Resources Tax Law and improve waste management, in particular, increasing recycling of waste materials as an alternative to land-filling and incineration.

d) by end-June 2011, adopt a comprehensive second National Energy Efficiency Plan, assigning responsibilities and financing for relevant ministries/services and needed measures, as well as addressing energy saving potential in end-use consumption, transmission/distribution and energy generation (e.g. enhancing incentives for high-efficiency Combined Heat and Power Generation and district heating, as well for thermal renovation of existing buildings).

12. **To implement effective active labour market and education policies:**

a) by end-July 2011, prepare proposals to the Commission as regards re-allocating sufficient additional funding within EU Structural Funds for active labour market measures in 2012-2013; in this context, line ministries in cooperation with social partners and branch associations shall assess the adequacy, priorities and financing of existing and planned active labour market programmes, with a view to facilitate through training and other activation measures the participants' transition to regular employment, including self-employment. Improve supply of relevant labour market skills by promoting up-skilling, re-skilling and work-based training measures.

b) by end-September 2011, introduce monitoring system of training providers, based on, inter alia, job placement rates and customer survey results, and by end-March 2012, complete an independent evaluation of the voucher system functioning, in particular as regards relevance of training to labour market needs.

c) during 2011, further strengthen the capacities of the State Employment Agency to allow more efficient job counselling services through a lower number of unemployed per case-handler and introduction of innovative working methods.

d) continue reforms in vocational education by, inter alia, consolidating the number vocational education institutions and assessing the study programmes in line with labour market needs and implementing the "money follows student"; continue reforms in higher education by assessing and consolidating the study programmes, concentrating the resources, and implementing the performance based financing.

13. **To improve state and municipality owned asset and real estate management:**

a) by end-November 2011, adopt a strategy setting good corporate governance principles for state owned companies, including clear selection criteria for politically-independent and professional appointments to state- and municipality-owned companies' boards and councils, as well as devise adequate remuneration policy to attract high-level professionals.

b) by end-October 2011, submit to international lenders an assessment of options as regards possible restructurings, (partial) privatizations, and management structure of government and municipality-owned companies; this assessment should be done taking into account objectives of efficiency, profitability and transparency.

c) by end-October 2011, develop recommendations for further state real estate management optimization, including re-assessment of the financing model and centralization of the administration and management functions.

14. **To strengthen public procurement:**

a) by end-June 2011, strengthen training activities for public officials involved in procurement activities and internal procedures of ex ante controls to minimize risks of incorrectly applied procurement legislation.

b) by end-September 2011, in cooperation with the relevant organized business organizations, review the efficiency of current Electronic Procurement System (EPS) and submit to the Cabinet of Ministers the necessary legal amendments to expand mandatory EPS usage and allocate the necessary financial resources for EPS support and development as well as addition of new product groups.

c) by end-October 2011, in cooperation with the relevant organized business organizations (and considering effects on micro and small enterprises), submit legal proposals on making centralized municipal procurements compulsory; in this context, limit the scope of "in-house" procurements.

d) by end-May 2011, establish a working group for devising administrative responsibility/penalties for violations in public procurement processes; by end-October 2011, prepare and submit the respective legal acts to the Cabinet of Ministers in view of their implementation from March 2012; allocate the necessary resources for the Procurement Monitoring Office to assume the new responsibilities.

15. To strengthen competition in open markets:

a) by end-October 2011, submit the outstanding amendments to sector-specific legislation within the context of transposition of the Service Directive, including in key services sectors such as regulated professions, construction and retail in order to facilitate establishment and provision of cross border services while providing legal certainty.

b) by end-October 2011, ensure that the electronic Point of Single Contact, set up pursuant to the Services Directive, is operational; by end-December 2011, present a progress report on implementation of the Services Directive, including on online procedures and steps to be taken over the next quarters to finalise the electronic completion of procedures, setting out clear deadlines by service sector and procedure.

16. To support job creation, SMEs and the business environment (in cooperation with the relevant business organizations), **as well as improve rail transportation infrastructure**:

a) by end-September 2011, in cooperation with the relevant business organizations and the private sector actors, prepare a draft state program for promotion of new production capacities, including in less developed territories, and allocate sufficient financing for the programme within 2012 budget or other financing sources.

b) by end-June 2011, submit the plan to the Cabinet of Ministers to reduce the administrative burden, by implementing the functional audits' proposals on "reducing administrative burdens for entrepreneurs", "reducing monitoring and controlling activities of educational institutions" and "centralizing of support functions".

c) by end-2011, ensure a wider application of e-governance services and promoting use of e-signature both by the public and private sector.

d) by end-2011 ensure significant progress related to the Rail Baltica construction financed by TEN-T, in particular the direct 120 km/hour railway connections Riga-Kaunas and Valka-Riga.

ANNEX II MONITORING AND REPORTING REQUIREMENTS

(This Annex complements Annexes II of the MoU and the First/Second/Third SMoU)

During the implementation of the European Union assistance, the following indicators and reports shall be made available to the Commission by the relevant authorities (in addition to the requested reporting as set out in the original Memorandum of Understanding and Supplemental Memorandums). Furthermore, ***reporting information provided to other multilateral and bilateral lenders*** *involved in the program of financial assistance, of which the assistance provided by the EU forms part,* ***shall also be provided to the Commission****:*

Monitoring fiscal developments

- Bi-weekly Treasury cash-flow assessment of central government financing needs.
- Monthly revenue and expenditure break-down of social budget, including data on social benefits' hand-outs (unemployment, family, etc); monthly state basic budget expenditure breakdown per type of expenditure for each ministry or other relevant budget entity; monthly revenue and expenditure break-down of local governments, including data on GMI hand-outs and other benefits included in category "other social support".
- Monthly information on central government (i.e., ministries and agencies) and state owned companies' staff and remuneration levels, institution-by-institution, showing last months'/years' trends.
- Monthly data (quarterly data from 2012) on general government arrears, including to suppliers; quarterly information on debt stocks and flows and guarantees given on new debt, contracted by the (i) consolidated central, local and general governments and (ii) public enterprises; bi-Monthly data on new contingent liabilities of the consolidated central, local and general governments.
- Bi-Monthly data (quarterly data from 2012) on state budget loans and PPP projects.

Monitoring financial developments

- Monthly statements of the operations on the special account; monthly report on outstanding loans split by currency and detailed to households (housing, consumer, other) and non-financial corporations (by sector).
- Notify DG ECFIN whenever there is a consultation process with DG COMP related to financial sector stabilization.
- Monthly report on banking sector stabilization measures; monthly report on the evolution of the parent banks' exposure towards Latvia, which encompasses all forms of debt instruments and capital as well as net deposits provided to banks in Latvia.
- By end-October 2011, the Financial and Capital Market Commission shall present to the EC report on the implementation of strengthened supervisory and monitoring framework, focusing on developments in banks' loan portfolios, provisions for losses, liquidity and capitalisation, to be closely watched by means of, inter alia, regular on-site inspections and stress tests.

Monitoring structural reforms

Structural Funds and Cohesion Fund

- Regular consolidated and cross-checked reports on expenditure and revenue forecasts regarding overall EU and other foreign financial assistance, distinguishing clearly between government spending on behalf of the EU and spending corresponding to the national co-financing.
- Monthly data on budget allocations to and appropriations of line ministries for financing of EU Structural funds and Cohesion fund projects (including which programme and programming period they are related to); monthly data on the amounts disbursed to final beneficiaries for project implementation, by ministry and by EU Structural funds and Cohesion fund activities (including specific information on amounts of expenditure really incurred, advance payments – declarable and not declarable – and allocations to financial engineering instruments).
- Monthly data on the amounts spent by state budget financed entities as final beneficiaries on EU Structural funds and Cohesion fund project implementation, by ministry and by EU fund (including which programming period they are related to).
- At the middle of each quarter, qualitative assessment reports by the Managing Authority on reaching the Structural Funds and Cohesion Fund expenditure targets; at the end of each quarter, report on the management capacities of the SF Managing Authority, Audit Authority, Certifying Authority and the Intermediate Bodies: number of staff and total remuneration by body, including comparison with 2010 and previous quarters.

Active Labour Market and Social Policies

- Quarterly flash reports on the implementation of the ALM measures by the Ministry of Welfare, Ministry of Economy and Ministry of Education including number of participants, (total planned/the total unemployed, unemployed exiting the Workplaces with stipend program), problems encountered and solutions proposed.
- At the end of each quarter, report on the capacity of the State Employment Agency (SEA): number of clients per staff member, time allocated for a client, frequency of client contacts including comparison with 2010 and previous quarters.
- In the beginning of every quarter, assessment of policy options taken during the previous quarter regarding poverty, health and pensions (including data on allocations for GMIs and also in comparison to previous years).

A copy of all information requests and reports shall be sent to the to DG ECFIN mailbox (ecfin-lv-bop-data@ec.europa.eu), as well as to current recipients of the reporting system.

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together 14 pages
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G.Kauliņš