Board Meeting of May 19, 1998
Statement by Joaquim Carvalho

Latvia—Country Assistance Strategy

We endorse this proposed Country Assistance Strategy for Latvia as we find it to be consistent with the government’s reform agenda of strengthening the macro-economy and financial sector, accelerating private sector development, redefining the role of the state, developing the sub-national capacity, and improving the social protection and quality of delivery of social services.

We acknowledge the turnaround in the economic situation of Latvia as a result of the stabilization measures put in place in the last two years. The economy has grown at an unprecedented rate, the exchange rate has been stabilized, and inflation is under control, while unemployment is on the decline. The pace of structural reform has also been very impressive, with the privatization process almost completed, and foreign investment and trade increased as a result of trade liberalization measures that have opened up the economy. While the achievements of the Bank-supported economic reform program have been remarkable, many challenges remain. Macroeconomic stability is still fragile, public administration capacity remains weak and structural reforms need to be deepened.

We welcome the CAS’s focus on private sector development and are pleased to note that the privatization of small and medium scale state-owned enterprises is almost completed. We concur with the Bank’s proposal to deepen its dialogue with the Latvian authorities in order to accelerate the privatization of the large enterprises. Caution should, however, be taken to ensure that privatization of these large enterprises does not result in transforming them from public monopolies to private monopolies. Given the pace of private sector growth and privatization in Latvia, we would have expected that IFC’s program would have been a little larger than that indicated in the document. We believe that the present investment climate provides an excellent opportunity for the Corporation to be more active in Latvia. In this regard, the Corporation should take a more proactive in assisting the country in the privatization of the remaining state owned enterprises as well as in post-privatization financing. We also hope that with the
completion of its membership in MIGA, the Agency will be in a position to assist in attracting more foreign direct investment to the country by providing guarantees for private investment.

The reform of the financial sector is equally important, especially the need to increase the monitoring of exposure, maintain vigilance in the event of a sudden shift in capital flows, and further strengthen supervision of both bank and non-bank financial intermediaries. We therefore consider the Bank Group’s strategy to assist the government in this area to be appropriate.

On the government’s plan to give priority to the promotion of the least regions, we consider the efforts to address the problems of the disadvantageous regions to be very appropriate. We, therefore, support the proposed Rural Development Project which is expected to stimulate entrepreneurial activities in the most depressed localities in the rural areas and to enhance the inhabitants’ income levels. We also welcome the government’s efforts to improve the country’s legal and judicial capacity to ensure the independence of the judiciary, as this will reduce crime and corruption, enhance the predictability of the legal system, while also providing a more conducive environment for foreign investment.

In redefining the role of the state, we recognize the importance of strengthening the institutional capacity of the public sector and are therefore pleased with the ongoing reform of public administration to streamline public sector functions and improve its management. We also welcome the EDI’s involvement in organizing seminars and providing information on best practices. The non-lending activities and IDF grant being proposed would help the country to improve its institutional capacity and combat corruption. One area of concern is that regarding the regional fragmentation and the weak institutional capacity of Latvia’s local governments. These government entities are being given responsibilities without necessary resources or the institutional capacity to match them. We are, however, pleased to note that the government has launched a reform program to consolidate the sub-national entities and that efforts are being made to match the assigned functions with adequate resources. We also believe that both the lending and non-lending activities proposed for this area are appropriate.

On poverty alleviation programs, we note the government’s efforts to ensure universal access to health services and education at affordable cost and applaud the government’s plan to improve the quality of, and access to, education and health. We hope that with the completion of the social assessment of poverty in Latvia, the government, with the help of its development partners, will be able to improve the delivery of essential social services.

We endorse the lending levels and the associated triggers as well as the mix of Bank lending and non-lending services proposed in the CAS. Particularly noteworthy is the extent the Latvian authorities value the Bank’s policy advice and express preference for a high share of non-lending services relative to lending interventions with their readiness to contribute to the cost of carrying out the agreed programs. We concur with the CAS that the Bank’s support should be selective and limited to those areas where it would have maximum impact. We, however, observe that the Bank turned down the government’s request for assistance in the major sub-sectors such as power, highway and industry. While we are told in the document that the decision was taken with the full understanding of the government,
we would be interested to hear from the staff about the underlying reasons in the Bank for taking this position.

Finally, we commend staff for this well-prepared document and the consultative process, which preceded it. We are optimistic that Latvia will continue its remarkable progress in stabilization and structural reform as it addresses the enormous challenges of sustainable growth and poverty reduction.