LATVIA

Reimbursable Advisory Services
To the Ministry of Transport of Latvia

REVIEW OF THE PORTS SECTOR OF LATVIA:
COMPETITIVENESS AND GOVERNANCE

Final Report

October 2013

The World Bank
# Table of Contents

Executive Summary .............................................................................................................. 3  
Introduction .......................................................................................................................... 5  
1. Overview of the Port Sector ............................................................................................. 5  
   1.1. Background .............................................................................................................. 5  
   1.2. Regional Traffic is Growing Rapidly ...................................................................... 12  
   1.3. Recent performance of Latvian ports ....................................................................... 14  
   1.4. Prospective ............................................................................................................. 20  
2. Supply Chain .................................................................................................................... 22  
   2.1. National Port and Transit Sector Strategy ............................................................... 22  
   2.2. Shipping Services .................................................................................................... 24  
   2.3. Land transport ........................................................................................................ 25  
   Recommendations ......................................................................................................... 29  
3. Pricing policy and sustainability of ports development ..................................................... 30  
   3.1. Revenues and pricing policy .................................................................................... 30  
   3.2. Expenditure ............................................................................................................. 33  
   3.3. Surplus and investment capacity ............................................................................. 35  
   3.4. Taxation and dividends ........................................................................................... 39  
   Recommendations ......................................................................................................... 40  
4. Management Practices ..................................................................................................... 41  
   4.1. Key Performance Indicators .................................................................................... 41  
   4.2. Transparency .......................................................................................................... 44  
   4.3. Land allocation ........................................................................................................ 46  
   4.4. Free zone development and towing services ........................................................... 48  
   Recommendations ......................................................................................................... 50  
      Key Performance Indicators ........................................................................................ 50  
      Transparency .............................................................................................................. 50  
      Land allocation .......................................................................................................... 52  
      Free zone development and towing services ............................................................ 52  
5. Governance and accountability ......................................................................................... 54  
   5.1. Legal framework ...................................................................................................... 54
5.2. Oversight – The role of State, Municipalities and the Port, Transit and Logistics Council........................................................................................................................................56
5.3. Supervision- The role of the Boards .........................................................................................................................................................................................57
5.4. Management – The relationship between Board and CEO ..................................................................................................................................................61
5.5. Audits .........................................................................................................................................................................................................................................................61
Recommendations ......................................................................................................................................................................................................................63
Legal Framework ...............................................................................................................................................................................................................................63
Oversight and general structure ........................................................................................................................................................................................................64
Supervision ..............................................................................................................................................................................................................................................66
Management ...............................................................................................................................................................................................................................................66
Audits ......................................................................................................................................................................................................................................................66
Executive Summary

1. **Ports play an important role in the economy of Latvia.** The share of GDP derived from port activities has been estimated at 5 to 7 percent of GDP. Latvian ports, which operate as landlord ports, handle more than 60 million tons of cargo per year and transit cargo accounts for the largest volumes. Bulk cargoes (especially oil and coal) are the major business of Ventspils, while Riga handles both bulks and containerized cargo. Ventspils also handles a growing volume of Ro-Ro traffic.

2. **Concerns have recently emerged over the competitiveness of the Latvian ports** – and how to maintain and improve it in the face of strengthening competition from other east-west trade corridors. Demand for the services of both Riga and Ventspils has continued growing, but they have been losing part of their market shares to the Russian ports of St. Petersburg, Ust Luga and Primorsk. These three Russian ports have benefited from substantial investments in modernization and expansion and require no border crossing to the Russian hinterland. In conjunction to its overall economic dialogue with the European Union, the Government committed to the European Commission “to review ports’ taxation regimes (special economic zones) and make efforts to increase the effectiveness and transparency of their governance”.

3. **In December 2012, Latvia’s Ministry of Transport (MOT) contracted the World Bank to carry out a review of the Latvian port sector.** Its objective is to review the operations and management of the main ports of Latvia, and to make recommendations, if needed, (i) to strengthen the ports’ international competitiveness and (ii) to ensure that their governance practices are in line with good international experience.

Key issues and challenges of the Latvian ports and transit corridors

4. **The review of the competitiveness aspect highlights that both ports managed to maintain significant traffic (and increase it for Riga) but with structural long-term weaknesses:**
   (i) Dependence of both ports on transit cargo (close to 90 percent) and dominance of low value added bulk traffic;
   (ii) Limited prospects for development of high value added traffic due to limited domestic market and very strong competition especially from Russian ports.

5. **Latvian Ports do face constraints to maintain or increase their competitiveness:**
   (i) Externally, inadequate freight capacity of the railway in the Latvian links of the main corridors, due to infrastructure, congested rail and road access in Riga;
   (ii) Latvian Ports do not have inner specific advantages compared to Russian Ports (larger domestic market, less borders to cross for each CIS country) and other Baltic ports (similar characteristics but more proximity to larger Western EU markets for Lithuania, and similar characteristics for Estonia, much larger domestic market for Poland);
   (iii) Internally, investment needs in Riga to accommodate larger ships and increase handling efficiency (insufficient water depth and length at existing container terminals, outdated gantry cranes and yard equipment), limited financial capacity for development and lack of interest from major blue chip operators or industries which could use the ports’ free zones.

6. **Financial sustainability of Latvian Ports to support their development will require the ports to adapt revenue generation and the Government of Latvia to carefully consider its port taxation policy.** Both Riga and Ventspils ports are financially self-sufficient without public/taxpayer funding except EU cohesion Funds for part of their investment. They reinvest their generated surplus in infrastructure and modernization. However, projected surpluses, in particular in Riga, are insufficient to support future investment programs; all the more that Latvia has very strong competing needs on railways and
intermodal interfaces that are critical to the ports competitiveness and would be the likely preferred allocation of EU Cohesion Fund. Port tariffs are low by regional standards and may have some margin for increase, but ports probably also have some margin to decrease their costs based on their overall cost figures\textsuperscript{1}. There is also scope to diversify revenue especially from land use. As the government also considers additional taxation to the port system, price competitiveness should however be paramount so that the overall setting can sustainably develop.

7. The review of the governance aspect of the Latvia port sector reveals three major issues which have affected management practices currently being used in the ports and competitiveness of the ports:

- Lack of independence of port boards due to political appointment processes and emphasis on political accountability of each individual to its appointing authority, and uneven consideration of professionalism criteria in appointments;
- Weak collective accountability of the port management and of the boards to the State and Municipalities who entrusted them with management of public assets; and
- Limited transparency in decision-making process and in activities of the ports that cause multiple allegations and, thus, affects the confidence of current and potential investors and operators.

Recommendations

8. Latvian ports will face significant challenges to increase their competitive advantage, given the fierce competitive environment. However, they can improve their competitiveness thanks to:

- better landside connectivity/supply chain, starting with addressing the railway constraints and the access constraints to Riga;
- better investment policy to ensure value for money;
- financial independence and sustainability to sustain investment through improved cost and revenue management especially for land related revenue; this may be helped by a detailed operational audit covering both costs and revenues beyond standard financial audits or these usually conducted by the government’s audit authorities;
- more efficient land management through modernization of contracts for shorter terms and introduction of performance indicators where possible; and
- structured efforts to attract international and local investors in logistics services and high value added services around the ports in the free zones.

9. To attract investors and to ensure accountability of the Ports to the public, governance practices need to be improved through:

- strengthened accountability of ports through strengthening the role of the boards, ensuring the evaluation of the boards and CEO performance, operational audits. This would probably require a change in the law that puts the Ports’ legal status closer to the framework applicable to companies;
- increased transparency in practices through the adoption of a positive disclosure policy of main actions and decisions to the public; and
- introducing and mainstreaming monitoring processes both for the port and main operators through use of Key Performance Indicators.

\textsuperscript{1} The study could not have access to any detailed cost data from the Ports to determine with accuracy where cost savings could be done.
Introduction

10. **Ports play an important role in the Latvian economy.** Latvia has long established itself as a transit country (mainly for Russia, Belarus, Ukraine, and Central Asia) and its ports handle more than 60 million tons of cargo per year. The main ports are Riga and Ventspils (and to a lesser extent Liepaja). Overall, transport and logistics account for about 13 percent of GDP (and were relatively resilient during the 2008-2009 crisis).

11. **Concerns have recently emerged over the competitiveness of the Latvian ports** – and how to maintain and further improve it in an increasingly difficult environment. Traditional competitors of the Latvian ports include Klaipeda (Lithuania) and Tallinn (Estonia), as well as St. Petersburg and Primorsk (Russia). The recent development and rapid growth of Ust-Luga (Russia), however, may alter the equation, by absorbing an increasing share of the trade with the Russian hinterland. In parallel, the Latvian authorities would like to position the ports in such a way that the share of high value added activities can gradually increase.\(^2\)

12. **As part of the competitiveness agenda, the authorities are also interested in strengthening ports governance.** In this respect, there are discussions on how to best set objectives and incentives for the ports’ management, to strengthen accountability, and to improve management practices. The Government committed to the European Commission “to review ports’ taxation regimes (special economic zones) and make efforts to increase the effectiveness and transparency of their governance”.

13. **Against this backdrop, the Ministry of Transport has requested the World Bank to carry out a review of the sector.** The objective of this work is to review the operations and management of the main ports of Latvia, and to make recommendations, if / as needed, (i) to strengthen the ports’ international competitiveness and (ii) to ensure their governance practices are in line with good international experience The study was intended as a review of relevant regulations and practices but was not meant to articulate a strategy for the Ports. The review was carried out based on the analysis of the data provided, discussions with various sector stakeholders, and comparisons with international practices (it was not expected to dwell on specific incidents or allegations). Access to information was either limited or not possible at all especially with regard to port authorities’ detailed costs and revenues, which limited the authors’ diagnostics and recommendations. The study focused on the ports of Riga and Ventspils (the Ports), and to a lesser extent Liepaja, within the broader context of the Baltic Sea trade.

14. **This report presents the conclusions of the review.** Chapter 1 provides an overview of the port sector and a brief analysis of its competitiveness. Chapter 2 examines the role and the performance of the ports as part of extended logistics chains. Chapter 3 presents an analysis of pricing and taxation policies. Chapter 4 discusses management practices in the ports. Chapter 5 reviews governance and systems for accountability.\(^3\) The core recommendations made in the report consider the current legal status of Latvian ports except in cases where explicit recommendations to change the law are recommended.

1. Overview of the Port Sector

1.1. Background

---

\(^2\) See Box 1.

\(^3\) For the purpose of this study, governance refers to the framework of rules and practices by which the board ensures accountability, fairness, and transparency in a company's relationship with its stakeholders (financiers, customers, management, employees, government, and the community). The governance framework consists of (1) explicit and implicit contracts between the ports and the stakeholders for distribution of responsibilities, rights, and rewards, (2) procedures for reconciling the sometimes conflicting interests of stakeholders in accordance with their duties, privileges, and roles, and (3) procedures for proper supervision, control, and information-flows to serve as a system of checks-and-balances. (Source: OECD Principles of Corporate Governance).
15. The port sector makes a major contribution to the national economy of Latvia. The share of GDP deriving from port activities has been variously estimated at 5 to 7 percent of GDP. Roughly 30 percent of exports of services are related to transit cargo. Ports also provide a significant number of jobs, directly and indirectly: Riga Port accounts for about 10 percent of the city’s workforce (5,200 direct and 15,000 indirect jobs), and Ventspils Port for about 20 percent of the city’s workforce (4,000 direct and indirect jobs). The sustained performance and the competitiveness of the port sector are hence key to the country’s economic prospects – and of interest not only to ports’ stakeholders but also to the society at large.

16. The traffic of Latvian ports present several characteristics that are important for an analysis of its competitiveness:

- **Riga and Ventspils dominate the port sector.** These two ports (which handled respectively 36.1 million tons and 28.5 million tons in 2012) account for over 90 percent of the total cargo volume. Liepaja (6 million tons) and seven smaller ports account for the rest. Riga handles about 4,000 vessels per year, and Ventspils about 1,500.

- **The two main Latvian ports are medium-size ports in the European and global context.** They are comparable in size with their main competitors in the Baltic region. Their traffic is comparable to Klaipeda, Tallinn, and Ust Luga, and about half of St. Petersburg and Primorsk.

- **Transit cargo accounts for the largest part of the traffic** (about 80 percent in Riga, and 90 percent in Ventspils). Most of the dry and liquid bulk cargoes are transit cargo shipped by rail from Russia and neighboring countries and loaded into chartered vessels to Northern Europe and overseas. Outbound traffic represents about 90 percent of this transit, inbound 10 percent. The main countries of origin are Russia and other CIS countries, the main destinations are the UK, Germany, the Netherlands, and Scandinavia. Latvian ports are very vulnerable to decisions made by Russian authorities and operators (e.g., changes in tariffs charged by the Russian railways over the last decade severely affected transportation of metals and several other types of bulk and general cargo, which have now moved away from Latvian ports).

- **The ports are largely specialized in coal (esp. Riga) and oil products (especially Ventspils).** Coal and oil products account respectively for 40 percent and 22 percent of the traffic in Riga, and for 23 percent and 51 percent of the traffic in Ventspils. Overall, the Latvian ports handle about 23 million tons of coal and 25 million tons of oil and oil products per year. This specialization has significantly increased since the early 2000s. Other bulk cargoes (mainly timber and fertilizers) account for another 10 to 15 percent of traffic.

- **High value added cargoes remain limited** (see Box 1). Containers account for less than 10 percent of traffic in Riga, and are not handled in Ventspils. RoRo accounts for 6 percent of traffic in Ventspils and less than 2 percent in Riga.
Box 1. Main Value Added Services Potentials

Value added services can be divided into value-added logistics (VAL) and value-added facilities (VAF). VAL has two major components: general logistics services (GLS) and logistics chain integration services (LCIS). GLS are, among other activities, loading and unloading, stuffing and stripping, storage, warehousing, and distribution. These are the more traditional logistics activities and do not directly affect the nature of the product as it moves through the port. Beyond these traditional activities, more complex LCIS are being developed. Logistics service providers may take over parts of the production chain (for example, assembly, quality control, customizing, and packing) and after sales services (for example, repair and reuse). However, LCIS are only appropriate for certain types of goods. The products that have the highest potential to benefit from such services include consumer electronics, pharmaceutics, chemical products (except for those carried in bulk), clothing, cosmetics and personal care products, food, machinery, and control engineering products.

Value added facilities (VAF) are very diverse. These types of activities cannot generally be assigned to a particular type of product or freight flow. It is possible, however, to impute a certain VAF potential by analyzing freight flows such as dry and liquid bulk, general cargo, containerized cargo, and roll-on roll-off. A large container throughput might create the economic basis for establishing container repair facilities, handling vast quantities of chemicals requires port reception facilities, and substantial roll-on roll-off traffic might justify truck maintenance and repair. The figure below broadly depicts the potential for both VAL and VAF activities for different types of cargo.

Containerized and general cargoes typically have the highest VAL potential. GLS and LCIS have the best opportunity to serve these cargoes. The VAL potential for roll-on roll-off is very limited. Trucks with drivers are too expensive to be delayed while the cargo is modified; additionally, these loads are usually customer tailored. VAF, such as tanking, cleaning, repair, parking, security, renting, and leasing facilities have a better potential to serve the roll-on roll-off market. Dry and liquid bulk flows have the lowest potential for both VAL and VAF.

17. **The Ports are operated as landlord ports.** The landlord port is a model characterized by a mixed public-private orientation (see Table 1). Under this model, the port authority typically acts as landlord and as a regulatory body, while port operations, especially cargo handling, are carried out by private companies. This model is appropriate for ports with the characteristics of Riga and Ventspils.

**Table 1. Basic Port Management Models**

<table>
<thead>
<tr>
<th>Type</th>
<th>Infrastructure</th>
<th>Superstructure</th>
<th>Port labor</th>
<th>Other functions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public service port</td>
<td>Public</td>
<td>Public</td>
<td>Public</td>
<td>Majority public</td>
</tr>
<tr>
<td>Tool port</td>
<td>Public</td>
<td>Public</td>
<td>Private</td>
<td>Public/private</td>
</tr>
<tr>
<td>Landlord port</td>
<td>Public</td>
<td>Private</td>
<td>Private</td>
<td>Public/private</td>
</tr>
<tr>
<td>Private service port</td>
<td>Private</td>
<td>Private</td>
<td>Private</td>
<td>Majority public</td>
</tr>
</tbody>
</table>

- Similar to other landlord ports, the port authorities of the Ports of Riga and Ventspils manage real estate, carry out port development and planning (through one-, five- and ten-year plans), undertake marketing of the location, provide maintenance and upkeep of port access and waterside. The port authorities have retained responsibility for dredging and ice breaking (which is carried out adequately). The ports are outsourcing some services, e.g., with regard to port security, safety of vessels and maintenance of infrastructure. A key responsibility of the landlord port is to manage the real estate, which includes economic exploitation/leasing out, long-term development, maintenance and improvement of basic infrastructure such as fairways, berths, access roads, and tunnels. While the port authorities have traditionally been responsible for providing the basic infrastructure and the private operators the superstructure and equipment for cargo

---

4 Sometimes top (or best performing) international terminal operators (ITOs), e.g., Dubai Port World (DPW), are mistakenly considered as fully privatized ports. There are no ITOs, including DPW, which run port authorities. Almost all top ITOs run container terminals only. The only significant country that has privately run port “authorities” is the UK. The ports were privatized in the UK between 1983 and 1991, with mixed results.
handling, an increasing proportion of the infrastructure is in fact being developed through private investment (especially in Ventspils for the more recent bulk and oil facilities).

- **Infrastructure is leased to private operating companies in both ports.** The terminal operators provide and maintain their own superstructure including buildings (offices, sheds, warehouses, container freight stations, workshops). They acquire and install their own cranes and other equipment, and arrange for stevedoring. There were 33 stevedoring companies operating in the Port of Riga in 2012, but only ten enterprises handling over one million tons of cargo per year. In Ventspils, port services are provided by ten private terminal operators, including for the handling, transshipment and/or storage (plus other services) of liquid bulk, dry bulk or general cargo.

- **Ports also manage adjacent industrial areas, as free zones.** Under the current Law on Riga Freeport, 2000, and the Law on Ventspils Freeport, 1997, Riga has been operating as a freeport for 13 years, and Ventspils for over 15 years. The Port of Liepaja is part of Liepaja’s Specialized Economic Zone (SEZ). Companies operating in the Ports and SEZs may benefit from corporate income tax and real estate tax discounts of up to 80 percent (the amount of rebate depends on investments made during the tax year), and other fiscal incentives.

### Table 2. Responsibilities of Private and Public Sectors in Latvian Port Sector

<table>
<thead>
<tr>
<th>Category</th>
<th>Element</th>
<th>Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land development</td>
<td>Development of new port areas</td>
<td>Port Authority</td>
</tr>
<tr>
<td>Maritime infrastructure</td>
<td>Capital dredging</td>
<td>Port Authority</td>
</tr>
<tr>
<td></td>
<td>Sea locks, dams &amp; exterior breakwaters</td>
<td>Port Authority</td>
</tr>
<tr>
<td></td>
<td>VTS/Radar</td>
<td>Port Authority</td>
</tr>
<tr>
<td></td>
<td>Light buoys &amp; navigation aids</td>
<td>Port Authority</td>
</tr>
<tr>
<td>Port infrastructure</td>
<td>Land reclamation</td>
<td>Port Authority</td>
</tr>
<tr>
<td></td>
<td>Internal locks, Docks quays, light buoys &amp; navigational aids, River</td>
<td>Port Authority</td>
</tr>
<tr>
<td></td>
<td>berth &amp; harbor basin dredging</td>
<td></td>
</tr>
<tr>
<td>Port superstructure</td>
<td>Pavements, Warehouses, sheds, Cranes and gantries, Link-spans,</td>
<td>Private Operators</td>
</tr>
<tr>
<td></td>
<td>pontoons, Terminal and office buildings, Operators, Leasing /renting</td>
<td></td>
</tr>
<tr>
<td>Public utilities</td>
<td>Firefighting, Police, pollution Control</td>
<td>Government</td>
</tr>
<tr>
<td>Infrastructure links</td>
<td>Railways &amp; metro links in area</td>
<td>Port Authority</td>
</tr>
<tr>
<td></td>
<td>Roads in area, Canals in area</td>
<td>Port Authority</td>
</tr>
<tr>
<td></td>
<td>Tunnels &amp; bridges in area</td>
<td>Port Authority</td>
</tr>
<tr>
<td>Port maintenance</td>
<td>Maritime infrastructure maintenance</td>
<td>Port Authority</td>
</tr>
<tr>
<td></td>
<td>Maintenance of port infrastructure and superstructure</td>
<td>Port Authority&lt;sup&gt;7&lt;/sup&gt;/</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Private Operators</td>
</tr>
<tr>
<td>Port services</td>
<td>Cargo handing</td>
<td>Private Operators</td>
</tr>
<tr>
<td></td>
<td>Technical-nautical services</td>
<td>Port Authority</td>
</tr>
</tbody>
</table>

<sup>5</sup> These are: Riga Central Terminal, STREK, Alpha Osta, Baltic Container Terminal, Naftimpexs, Man Tess, BLB Baltijas termināls, Riga Universal Terminal, KS Terminal and La Con.

<sup>6</sup> Law on Application of Taxes in Freeports and SEZ, 2001. The Law also provides for 50-70 percent tax rebates “for a taxation period if the accumulated amount of direct tax rebates and the rebates calculated for the taxation period do not exceed the percentage of the accumulated amount of investments to be applied to the relevant capital company” depending on the size of a company.


<sup>8</sup> According to the MOT, port infrastructure maintenance is in general the responsibility of a port authority in Latvia. Depending on the type and ownership of port infrastructure objects, their maintenance could be also the responsibility of private sector operators. Maintenance of port superstructure is the responsibility of private operators.
18. **Ports** do not operate in an isolated environment, but as part of logistics and trade facilitation chains in the country. Investors and operators increasingly look beyond the ports themselves to assess comparative advantages, based on issues related to logistics performance and the overall business environment. Several indicators provide an indicative assessment of Latvia’s performance compared to its competitors in that respect.

- **According to the Logistics Performance Survey for 2012 Latvia ranks behind other Baltic countries, with the exception of Russia.** Furthermore the country’s performance has been deteriorating since 2010 (the country slipped from 37th to 76th position). Latvia is ranked lower than its neighbors on almost every aspect. The two components whose score dropped most sharply between 2010 and 2012, and which are mainly responsible for Latvia’s lower rank, are outside the direct scope of policy regulation. The first one is “Ease of arranging competitively priced international shipments”, whose score declined from 3.38 in 2010 to 3.08 in 2012, or -20 percent. The second one is “Timeliness of delivery”, which went from 3.72 in 2010 to 2.92 in 2012, or -17 percent. Low scores in the latter can be explained by traffic congestion around major metropolitan areas (e.g., road/railway access to/from the port of Riga) that delay shipments. The two components that are more directly inside the scope of policy regulation dropped comparatively little. Firstly, the score of the component “Efficiency of the clearance process by border control agencies (including customs)” only dropped by 8 percent (from 2.94 in 2010 to 2.71 in 2012). Secondly, the score of the component “Quality of trade and transport related infrastructure (e.g., ports, railroads, roads, information technology)” only dropped by 13 percent, as compared by drops in the rating of the other three components (arranging shipments, tracking and tracing and timeliness) between 16 and 20 percent. Although it is not possible to draw clear-cut conclusions without a detailed understanding of the current situation on the ground, border management (which is part of “Efficiency of the clearance process by border control agencies” component) might emerge as one of the probable causes for the decrease in Latvia’s performance. A number of tools exist to independently assess this in a more detailed manner, such as the Trade and Transport Facilitation Assessment which has been implemented by the World Bank in over 50 countries.

### Table 3. Logistics Performance Survey (2012)

<table>
<thead>
<tr>
<th>Country</th>
<th>Years</th>
<th>LPI Rank</th>
<th>Customs</th>
<th>Infrastructure</th>
<th>International shipments</th>
<th>Logistics competence</th>
<th>Tracking &amp; tracing</th>
<th>Timeliness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore*</td>
<td>2010</td>
<td>2</td>
<td>4.02</td>
<td>4.34</td>
<td>3.66</td>
<td>4.14</td>
<td>4.18</td>
<td>4.48</td>
</tr>
<tr>
<td></td>
<td>2012</td>
<td>1</td>
<td>4.10</td>
<td>4.15</td>
<td>3.99</td>
<td>4.07</td>
<td>4.07</td>
<td>4.39</td>
</tr>
<tr>
<td>Poland</td>
<td>2010</td>
<td>30</td>
<td>2.94</td>
<td>2.88</td>
<td>3.38</td>
<td>2.96</td>
<td>3.55</td>
<td>3.72</td>
</tr>
<tr>
<td></td>
<td>2012</td>
<td>30</td>
<td>3.30</td>
<td>3.10</td>
<td>3.47</td>
<td>3.30</td>
<td>3.32</td>
<td>4.04</td>
</tr>
<tr>
<td>Lithuania</td>
<td>2010</td>
<td>45</td>
<td>2.79</td>
<td>2.72</td>
<td>3.19</td>
<td>2.85</td>
<td>3.27</td>
<td>3.92</td>
</tr>
<tr>
<td></td>
<td>2012</td>
<td>58</td>
<td>2.73</td>
<td>2.58</td>
<td>2.97</td>
<td>2.91</td>
<td>2.73</td>
<td>3.70</td>
</tr>
</tbody>
</table>

9 ‘Ports’ term is used here as a general term encompassing a port authority and terminal operators.
10 The Logistics Performance Index (LPI) is a benchmarking tool launched by the World Bank in 2007. It is constructed on the premise that operators in each country are in the best position to assess the vital aspects of logistics performance. The results are based on a global survey of freight forwarders and express carriers, which measures the performance of a country’s logistics chain, and in particular: (i) the efficiency of customs and border management clearance, (ii) the quality of trade and transport infrastructure, (iii) the ease of arranging competitively priced shipments, (iv) the competence and quality of logistics; (v) the ability to track and trace consignments, and (vi) the frequency with which shipments reach consignees within scheduled or expected delivery times.
• **The Enabling Trade Survey for 2012 also places Latvia behind its Baltic competitors other than Russia.** It also records a drop from 46th in 2010 to 52nd in 2012. The ETI measures the extent to which individual countries have developed institutions, policies, and services facilitating the free flow of goods over borders and to destinations. The structure of the ETI reflects the main enablers of trade, breaking them into four issue areas that are captured in sub-indexes: (i) market access, (ii) border administration, (iii) transport and infrastructure, and (iv) business environment (WEF). Areas where Latvia ranks particularly poorly compared to its Baltic neighbors include customs procedures, transshipment connectivity, ease and affordability of shipment, and government efficiency in terms of regulations.

<table>
<thead>
<tr>
<th>Sub-indexes</th>
<th>Poland</th>
<th>Latvia</th>
<th>Estonia</th>
<th>Lithuania</th>
<th>Russia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall ranking</td>
<td>48</td>
<td>52</td>
<td>26</td>
<td>45</td>
<td>112</td>
</tr>
<tr>
<td>Burden of customs procedures, 1-7 (best)</td>
<td>45</td>
<td>65</td>
<td>13</td>
<td>42</td>
<td>127</td>
</tr>
<tr>
<td>Transshipment connectivity index, 0-100 (best)</td>
<td>53</td>
<td>92</td>
<td>89</td>
<td>90</td>
<td>41</td>
</tr>
<tr>
<td>Quality of railroad infrastructure, 1-7 (best)</td>
<td>75</td>
<td>37</td>
<td>44</td>
<td>25</td>
<td>30</td>
</tr>
<tr>
<td>Quality of roads, 1-7 (best)</td>
<td>125</td>
<td>94</td>
<td>47</td>
<td>31</td>
<td>121</td>
</tr>
<tr>
<td>Quality of port infrastructure, 1-7 (best)</td>
<td>99</td>
<td>48</td>
<td>17</td>
<td>41</td>
<td>89</td>
</tr>
<tr>
<td>Ease and affordability of shipment, 1-5 (best)</td>
<td>22</td>
<td>84</td>
<td>74</td>
<td>56</td>
<td>102</td>
</tr>
<tr>
<td>Logistics Competence, 1-5 (best)</td>
<td>33</td>
<td>89</td>
<td>65</td>
<td>57</td>
<td>88</td>
</tr>
<tr>
<td>Government efficiency (regulatory environment)</td>
<td>92</td>
<td>90</td>
<td>28</td>
<td>72</td>
<td>110</td>
</tr>
</tbody>
</table>

• **Latvia, however, ranks relatively well under the Doing Business 2013 survey, ahead of Lithuania, Poland, and Russia, and close to Estonia.** This suggests that the overall business environment is sound, and that the difficulties recorded in the two other indicators are related to specific weaknesses of the logistical chains.

<table>
<thead>
<tr>
<th>Specific sub-indexes particularly relevant for ports</th>
<th>Singapore</th>
<th>Estonia</th>
<th>Latvia</th>
<th>Lithuania</th>
<th>Poland</th>
<th>Russia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starting a Business</td>
<td>4</td>
<td>47</td>
<td>59</td>
<td>107</td>
<td>124</td>
<td>101</td>
</tr>
<tr>
<td>Dealing with Construction Permits</td>
<td>2</td>
<td>35</td>
<td>113</td>
<td>48</td>
<td>161</td>
<td>178</td>
</tr>
<tr>
<td>Trading Across Borders</td>
<td>1</td>
<td>7</td>
<td>16</td>
<td>24</td>
<td>50</td>
<td>162</td>
</tr>
<tr>
<td>Enforcing Contracts</td>
<td>12</td>
<td>31</td>
<td>24</td>
<td>14</td>
<td>56</td>
<td>11</td>
</tr>
</tbody>
</table>


12 The Doing Business survey was introduced by the World Bank in 2003. It ranks 183 economies on the basis of a global survey of private sector operators. It includes ten sub-indexes.
1.2. Regional Traffic is Growing Rapidly

19. *Over the last decade, the Latvian ports have benefited from a rapidly growing regional market.* The regional traffic went from about 128.8 million tons to 307.8 million tons between 2000 and 2012. This created significant opportunities for the Latvian ports to grow and develop. The growth slowed down during the crisis years of 2008 to 2010, but remained strong (due to the nature of the traffic).

Figure 3. Total Traffic Volume of Major Baltic Ports (million of tons)

20. *Traffic growth affected all types of cargoes though to a variable level.* Container traffic developed most rapidly. The growth for dry and liquid bulk was slower.

Figure 4. Total Traffic Volume for Key Comodities in Major Baltic Ports
Northwithstanding, competition has also intensified during the period. Latvian ports are very dependent on outbound cargoes that are originating in Russia or transiting through Russia – and they have very little influence over transit tariffs and delays. Since the early 2000s, Russia made an effort to develop its own ports on the Baltic Sea – including substantial investment in St. Petersburg’s container facilities, the construction of the port of Ust-Luga and the completion of crude oil pipelines to Primorsk and Ust Luga. This has had a significant impact on the Baltic market, and has significantly affected Latvian as well as Lithuanian and Estonian ports. Primorsk, St. Petersburg, and Ust Luga are now controlling almost 60 percent of the regional traffic (from 25 percent in 2000). The transformation has affected all types of cargoes (see Figure 6).

Figure 5. Market Shares of Major Baltic Ports in 2000 and 2012
1.3. Recent performance of Latvian ports

22. The port of Riga has managed to maintain, and even expand its market share in the region. It is the only non-Russian port that has managed to do so. Riga’s overall share of the regional market increased from 10 to 12 percent, while Tallinn dropped from 23 to 10 percent and Klaipeda from 15 to 11 percent. As a result, Riga has become the most important non-Russian port in the region. This is especially significant as it is taking place in the context of a growing market. In absolute value, outbound cargo traffic has grown continuously, even during the financial crisis, from 29.5 million tons in 2008 to 36.8 million tons in 2012. Inbound cargo traffic has been more volatile, but overall stable at 2 to 4 million tons. This success should be credited to an active port management, including effective marketing as well as efforts to improve the quality of services.
23. **Northwithstanding, this success has come at a cost, with possible risks for its sustainability:**

- *The growth in bulk cargoes in Riga is mainly due to the dramatic increase in shipments of coal and oil products – while the volume of other cargo remained stagnant, in part due to the increase in the rate of containerization of general cargo and to a decline in the production of Latvia’s wood exports. As a result, the port, which relied a decade ago on timber and wood, oil products, mineral and fertilizers, and limited shipments of coal, is now largely specialized in coal and, to a lesser extent, oil products. The coal (hard coal mined in the Kuzbass region of central Russia) is transported by rail to Riga, a distance of about 4,500 km requiring 9-10 days. The specialization in a single commodity controlled by a few foreign-based operators aggravates Riga’s vulnerabilities. The environmental cost of coal cargoes can also not be easily discarded.*

**Table 6. Cargo Handled by Riga (% of Total Tonnage)**

<table>
<thead>
<tr>
<th>Cargo</th>
<th>2001</th>
<th>2006</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Bulk Cargo</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>coal</td>
<td>8.2</td>
<td>42.1</td>
<td>39.6</td>
</tr>
<tr>
<td>oil products</td>
<td>23.2</td>
<td>19.3</td>
<td>22.1</td>
</tr>
<tr>
<td>timber and wood</td>
<td>28.6</td>
<td>11.8</td>
<td>7.8</td>
</tr>
<tr>
<td>mineral fertilizers</td>
<td>10.3</td>
<td>5.4</td>
<td>5.0</td>
</tr>
<tr>
<td>wood chips</td>
<td>3.4</td>
<td>4.8</td>
<td>3.1</td>
</tr>
<tr>
<td>ore</td>
<td>0.3</td>
<td>0.3</td>
<td>1.8</td>
</tr>
<tr>
<td>grain and products</td>
<td>0.6</td>
<td>0.6</td>
<td>1.6</td>
</tr>
<tr>
<td>peat</td>
<td>1.3</td>
<td>0.7</td>
<td>0.4</td>
</tr>
<tr>
<td>sugar</td>
<td>2.3</td>
<td>0.8</td>
<td>0.4</td>
</tr>
<tr>
<td><strong>General Cargo</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>building materials</td>
<td>2.3</td>
<td>2.7</td>
<td>1.8</td>
</tr>
<tr>
<td>metals and products</td>
<td>6.7</td>
<td>0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>foodstuff and fruit</td>
<td>0.4</td>
<td>0.0</td>
<td>0.2</td>
</tr>
<tr>
<td><strong>Unitized and Other Cargo</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>goods in containers</td>
<td>6.5</td>
<td>6.0</td>
<td>8.9</td>
</tr>
<tr>
<td>roll on /roll off</td>
<td>1.2</td>
<td>1.2</td>
<td>1.6</td>
</tr>
<tr>
<td>other goods</td>
<td>4.6</td>
<td>4.2</td>
<td>5.4</td>
</tr>
</tbody>
</table>
Riga did not manage to develop high value-added activities. The container traffic increased to about 366,000 TEU in 2012, but it remains relatively marginal in the region (see Figure 8 and Figure 10). Only about 60 percent of the outbound containers are loaded (with wood from Latvia, cotton from Uzbekistan, and rubber, wood and high value metals from Russia, for delivery to Northern Europe and beyond), and about 40 percent of these boxes are delivered to the ports by rail. About 90 percent of the inbound containers are full (primarily with equipment and consumer goods shipped from Asia, 40 percent of which destined to the Latvian market). About 75 percent of the containers are moved inland by truck. The port of Riga handles only a very small amount of Ro-Ro cargoes. With more containers the port would better contribute to the economy with the possible development of connected activities (and an impact on economic growth, employment, and fiscal revenues).
• **Riga maintained low tariffs to remain competitive.** The revenues per ton of freight are among the lowest in the Baltic region (about 66 percent of those in Tallinn). This in turn has had an impact on the ports’ surplus (which is significantly lower than in Tallinn), and even more importantly on its capacity to invest. Indeed over the last period, investments in modern cargo handling equipment have been relatively limited. The larger terminal operators have achieved reasonable productivity given the age of their facilities and equipment, but they have limited potential for increasing throughput, serving larger vessels or competing with the modern terminals in other ports. Smaller terminal operators lack economies of scale and have significant room but not necessarily the capacity to increase their efficiency.

• **Riga may also have difficulties further expanding, and developing value-added facilities.** International experience suggests that large container terminals and value-added facilities cannot be squeezed into traditional port city centers because of congested access. They require greenfield locations with good road and rail access separated from the city street grid. Almost all value-added facilities adjacent to a seaport require ample space and easy road access, and therefore are found in new development areas outside the city. The port of Riga suffers the fate of many historic in-city ports: no free space for light industries that could process incoming goods for re-export, and inherently bad access, whether by road or rail, through the old city center.

• **Development of passenger and cruise services in Riga should follow an integrated approach.** While Riga attracts close to three quarters of a million passengers per year due essentially to the attractiveness of the city, Ventspils has marginal activities. There is probably room for increase of revenue/activity mostly in Riga but development depends on a multiplicity of factors beyond the

---

13 Revenues per ton were calculated based on total revenues generated by a Port Authority divided by total tonnage. In case of port of Tallinn, passenger revenues accounted for 38 percent (or 8.8 million passengers) in 2012. Thus, passenger revenues (Euro 42 million) and revenues from electricity sale (around Euro 6.5 million in 2012) were deducted from total revenues of Port of Tallinn before total revenues were divided by total tonnage. Similar adjustment with passenger revenues were not done for Ports of Riga or Ventspils, because passenger traffic is marginal in these two ports compared to Tallinn in terms of contribution to turnover – 750,000 in Riga in 2013 and 55,000 in Ventspils in 2011.
port authority’s control. A first step would be for a joint proactive marketing with the municipality and all cruise operators to assess where additional markets can be found.

24. The port of Ventspils has seen its market share decline dramatically – from 27 percent of the regional market in 2000 to only 9 percent in 2012. This decline is by far the largest among the non-Russian ports. Ventspils, which was heavily specialized in oil and oil products, was particularly affected by the development of Primorsk, which went from 6 percent to 43 percent of the oil traffic. Ventspils is also further from its markets than Riga, Tallinn, or Klaipeda. In absolute value, outbound traffic decreased from 35 million tons to 26 million tons, while inbound traffic remained volatile at about 2 million tons.

Figure 11. Cargo Loaded and Unloaded in Ventspils

25. The situation is compounded by several aggravating factors:

- **Ventspils remains heavily specialized, in oil products and coal.** The oil products are transported from Russia and Belarus via pipeline to Ventspils. Crude oil used to be shipped to Ventspils but most of this trade has been re-routed to Primorsk via a new pipeline that started operating in 2005 (the crude pipeline connecting to Ventspils has been closed). The loss of crude oil traffic was partly compensated by an increase in oil products and coal (following the establishment of dedicated export terminals by major exporters). Other kinds of bulk and general cargo that are handled in Ventspils are in much smaller volumes – in the range of 0.1 – 3 percent of total cargo volume (Table 7). Because other cargoes remain largely under-developed, with the exception of some bulk cargo shipments of potassium salt, this makes Ventspils still highly dependent on very few commodities. The Port of Ventspils has been efficient in securing long term investments from some of its main clients in order to guarantee traffic, such as coal (partnership with coal mine) and oil (partnership with international oil trader).

- **Ventspils does not capture much value added traffic.** Ventspils’ share of total RoRo traffic remains low, at only 16 percent (around 2 million tons), while Klaipeda’s and Tallinn’s shares are

---

14 Ventspils’ RoRo facilities are located closer to the shipping routes than Riga’s.
as twice as big – 32 percent (around 4 million tons) and 41 percent (5 million tons), respectively. Ventspils does not handle container traffic due to lack of domestic container market\textsuperscript{15} even if it has the space needed to develop adjacent activities.

Table 7. Cargo Handled by Port of Ventspils (% of Total Tonnage)

<table>
<thead>
<tr>
<th>Ventspils</th>
<th>2001</th>
<th>2006</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Bulk Cargo</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>coal</td>
<td>4.1</td>
<td>13.5</td>
<td>23.3</td>
</tr>
<tr>
<td>oil products</td>
<td>36.1</td>
<td>52.0</td>
<td>50.8</td>
</tr>
<tr>
<td>potassium salt</td>
<td>12.8</td>
<td>12.7</td>
<td>9.9</td>
</tr>
<tr>
<td>ore</td>
<td>0.0</td>
<td>0.0</td>
<td>2.9</td>
</tr>
<tr>
<td>Liquid gas</td>
<td>1.9</td>
<td>2.8</td>
<td>1.1</td>
</tr>
<tr>
<td>grain and products</td>
<td>0.1</td>
<td>0.4</td>
<td>0.8</td>
</tr>
<tr>
<td>wood chips</td>
<td>0.1</td>
<td>1.6</td>
<td>0.5</td>
</tr>
<tr>
<td>sugar</td>
<td>0.9</td>
<td>0.9</td>
<td>0.5</td>
</tr>
<tr>
<td>crude oil</td>
<td>39.5</td>
<td>6.7</td>
<td>0.1</td>
</tr>
<tr>
<td><strong>General Cargo</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>timber and wood</td>
<td>1.1</td>
<td>1.4</td>
<td>1.7</td>
</tr>
<tr>
<td>metals and products</td>
<td>2.7</td>
<td>0.2</td>
<td>0.4</td>
</tr>
<tr>
<td>building materials</td>
<td>0.0</td>
<td>0.0</td>
<td>0.2</td>
</tr>
<tr>
<td><strong>Unitized and Other Cargo</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>roll on /roll off</td>
<td>0.1</td>
<td>6.2</td>
<td>6.6</td>
</tr>
<tr>
<td>other goods</td>
<td>0.7</td>
<td>1.4</td>
<td>1.2</td>
</tr>
</tbody>
</table>

- Like Riga, Ventspils Port Authority kept tariffs (i.e. port dues) low to maintain competitiveness. Revenues per ton are the lowest in the region (about 38 percent of those in Tallinn), and yet the port has lost a large share of its traffic. This affects the level of profits (which are small) and the ability to invest. Ventspils has relatively modern facilities, and is hence under no immediate pressure to expand resources on further capacity development. However, the current situation may not sustainable, and the port may have to choose between increasing its tariffs or letting its capacity gradually erode – both unsatisfactory options. The combination of declining traffic and low charges suggests that the competitiveness issues faced by Ventspils are not necessarily related to the price of services.

Box 2. Competition with Finnish Ports

Finland is a significant transit country especially for imports of valuable items (machinery, consumer goods, etc.) to Russia and many CIS countries. This applies especially to unitized goods, particularly transported in containers, trucks, and trailers. In this respect, Finnish ports such as Helsinki and Hamina/Kotka provide a significant competition to Baltic ports as well as to the land corridor, e.g. via Poland and Belarus, to Moscow and North-West Russia. Over 10 percent of the value of total Russian imports are still transiting through Finland – this share used to be around 20 percent in years 2005-2007.

There are a number of factors that help the Finnish ports maintain and increase their competitiveness for high value goods. Among them is superior cargo safety and security by logistics service providers (including EU export customs clearance, warehousing and related services) which Finnish operators use as a marketing tool. For example according to Enabling Trade Survey for 2012, Finland is ranked no 1 in

\textsuperscript{15} Ventspils is at a disadvantage position compared Riga to serve the Russian container market; this is why it cannot compete with Riga or any other ports in the Baltic region for containers.
There is also some degree of competition on dry bulk cargoes (i.e. coming from Russia or CIS countries), where Finnish ports provide an alternative to ports in the Baltics or Russia’s Baltic Sea ports (such as St. Petersburg, Ust-Luga, Vyborg, and Kaliningrad). Substantial volumes of crude oil are also shipped from Primorsk (in the eastern end of Gulf of Finland) to Finland, but this is mainly for refining it to petroleum products in Finland in Skoldvik and Naantali refineries of Neste Oil Ltd; this would hardly be shipped through the Baltics.

For Finland, the calculated net value-added of all transit traffic activities (mostly to Russia, but also to other CIS) was approximately Euro 250 million in 2008, which is not very much when considering the approximately Euro 200 billion (or USD 250 billion) GDP.

**1.4. Prospective**

26. **Looking forward, the challenge for Latvian ports is to maintain their market shares in dry and liquid bulk (mainly coal and oil products) while developing high value cargo – containers, RoRo and general cargo.** To attract more high value cargo, the first and most critical point is to improve the costs and reliability of the entire logistics chain (e.g., by addressing road and rail access congestion and rail capacity, cf. the next chapter), as they are very sensitive to reliability and the land chain represents several times the cost of port operations. In addition, this could be facilitated by thinking through possible logistics clusters (as already happened in Estonia, which seems an appropriate experience at least in terms of methodology), by attracting firms which need to manage international supply chains to serve Northern Europe and CIS countries (including associated light manufacturing and packaging, especially for containers and general cargo) as well as world class operators. Developing logistics services for less than container loads (LCL) presents a good opportunity for Riga to generate value-added services out of containerized traffic (packaging, labeling, warehousing, etc.).

27. **Nevertheless, in the coming period, the Russian ports are expected to maintain or even further improve their service offering.** Primorsk, which has largely specialized in oil shipments, benefits from the relatively low cost of transports for crude oil and oil product through the two recently-completed pipelines, and of the significant level of state involvement in the petroleum industry. St. Petersburg is likely to maintain a significant comparative advantage (at least for containers) due to its proximity to Moscow, its recently-increased capacity, and its improved performance. Ust Luga is attractive for coal shipments, since it is around the same distance from the producing areas as Riga, does not require a border crossing, and offers a more modern facility which is controlled by a coal producing company (Kuzbassrazrezugol).

28. **Despite further growth in Russian cargo market in next decades, Russian ports may not leave much to their competitors in the Baltic to handle due to increase in planned investment projects to address infrastructure capacity constraints.** According to Russia’s Port Infrastructure Development Strategy for 2030, the volume of merchandise within Russian ports is estimated to grow to 1.3 billion tons, which poses a serious challenge in terms of infrastructure capacity to the Russian Federation.\(^\text{16}\) According to the

\(^{16}\) http://www.railwaypro.com/wp/?p=13326
Russian Railway Institute, until 2030, the external merchandize exchange transported by the company to and from the Russia’s ports will grow 3.3 times in the Western basin (Baltic sea and Gulf of Finland), 3 times in the Southern basin and 3.8 in the Far-Eastern basin. The North-Western basin is projected to become the main maritime gate for the hydrocarbon exports, Russian minerals and container-shipped goods. To respond to the continuing dramatic increase in demand, the highest growth capacity will be provided through the development of north-western and far-eastern ports in Russia, and also the construction of new ports and the development of the infrastructure in the arctic sphere of the Russian territory. These developments would likely to use a wide range of financing instruments, including state financing, non-budgetary financing and private investment. Therefore, there is still a possibility for ports in the Baltic region to keep and possibly develop market shares in some of the traffic.

29. **There is little space for Latvian ports to increase competitiveness by further tariffs reduction.** Both ports have exhausted the advantage which can be conferred by relatively low tariffs (they may in fact have to raise charges and duties, to regain their capacity to invest). They have hence no choice but to look for non-cost factors of competitiveness – effective logistics linkages within supply chains; adequate tariff policies; management practices; as well as governance and accountability. This is not a simple agenda, especially since the ports have already made significant progress over the last two decades in terms of modernization and reforms. There is no obvious “quick win”, but a series of areas in which action should be taken to regain or at least maintain competitiveness in a sustainable manner.
2. Supply Chain

30. **Ports are only one part of larger logistics chains.** For operators, importers and exporters, the focus is on the performance of the entire chain, rather than on the ports only. Costs, time, and reliability are the three main criteria that will make a chain competitive. Port costs typically represent no more than 10 percent of the final delivery costs. Time and reliability depend mainly on the connectivity provided by the shipping services and the interface with land transporters. For the ports, this implies the need to look beyond internal efficiency, and to strengthen synergies with other parts of the chain – namely to be able to receive adequate vessels, and to connect effectively with land transport.

31. **Both ports of Riga and Ventspils benefit from a strategic location.** They are well connected to the TEN-T motorway network, the TEN-T railway network, and the Motorways of the Baltic Sea (which connects Riga with TEN-T network ports such as Rotterdam, Antwerp, Hamburg). They share the Eastern European Railway gauge enabling cargo transportation from Russia, the CIS and Central Asian countries. They are connected to the Russian oil pipeline system (from Polotsk to Ventspils) with an annual capacity of 6 million tons. Riga has a slight advantage because it is 200 km closer by road or rail than Ventspils from Russia and most CIS markets.

2.1. National Port and Transit Sector Strategy

32. **To ensure the ports competitiveness, the Government has developed an integrated transit strategy,** which covers the entire logistics chain, from shipping lines, through ports, to land transport (road and railways). International experience suggests that this is a sound approach. The Government’s overall development strategy for the ports and transit traffic is laid down in two main documents: (i) “Transport Development Guidelines 2008-2013” and (ii) Latvia Port Development Programme for 2008-2013 (LPDP). Both documents are being updated for the 2014-2020 period and the new EU Financial Perspective cycle (key developments programmed at both Riga and Ventspils are being financed by the 2007-2013 EU Cohesion Fund). The Guidelines mainly provide an overview of the sector and cover key issues related to the entire transport sector, in line with the National Strategic Reference Framework (2008-2013). They are consistent with the National Development Plan and the strategies overseen by the Ministry of Transport. Both the Guidelines and the LPDP are relatively high level strategic documents, and they do not include detailed action plans to achieve the stated objectives.


| A corridor management approach has been adopted by Canada (Government of Canada, 2009) whose ports are in fierce competition for transit cargo with US ports, which is somewhat reminiscent of the Latvian ports’ situation. The key advantages of this approach are that it allows the country to (i) enhance multi-modal integration of major transportation systems, as well as their efficiency, safety, security, and sustainability, and (ii) address other, interconnected issues that impact on how well those systems work and how well the country takes advantage of them. This approach emphasizes rigorous analysis and long-term planning in partnerships among governments and between the public and private sectors. |

---

17 The Trans-European Transport Networks (TEN-T) are a planned set of road, rail, air and water transport networks in Europe. TEN-T envisages coordinated improvements to primary roads, railways, inland waterways, airports, seaports, inland ports and traffic management systems, providing integrated and intermodal long-distance, high-speed routes. A decision to adopt TEN-T was made by the European Parliament and Council in 1996.

18 The track is Russian gauge (1,520 mm) with a weight limit of 23 ½ tons per axle.
Five key criteria are applied to develop gateway/corridor strategies:

- International trade strategy;
- Volumes and values of national significance;
- Future patterns in global trade and transportation;
- Potential scope of capacity and policy; and
- The state’s role and effective partnerships.

33. The LPDP recognizes a number of factors which affect the dynamics of the transit services in Latvia, namely its strategic geographical location with ice-free ports\(^{19}\) and well-developed road and railway infrastructure, external demand, and the persistence of some of Russia’s transport infrastructure bottlenecks that still give them the possibility to compete in spite of the recent investments. It also presents strengths and weaknesses of and opportunities and threats for the larger and smaller ports.

34. The LPDP defines a number of sound objectives. It is articulated around a medium-term vision for the port sector, which is to develop Latvian ports in line with international standards and to join the unified transcontinental multi-modal transport corridors (by offering services with high added value, increasing cargo volumes, and ensuring high quality passenger services). The LPDP highlights the importance of developing container traffic, to provide an opportunity for business and the country at large to gain larger revenues. The LPDP also highlights the need for Latvia to maintain and strengthen its current positions within the dry and liquid bulk cargo sectors, and to pay special attention to attracting new cargoes from new markets. It aims to develop not only cargo flows from East to West but also from West to East.

35. The LPDP outlines seven objectives, namely: (i) to increase containers and Ro-Ro cargoes and reduce the dependency on export of raw materials to the West; (ii) to modernize port complexes and cargo terminals with adequate access road infrastructure; (iii) to facilitate entry of the transnational logistics companies and cargo terminal operators in the ports through public private partnerships; (iv) to achieve closer cooperation between ports, railways, and other types of transport so as to offer integrated logistics services; (v) to develop the ports in line with modern safety and environmental protection requirements, and to the benefit of the population living in adjacent territories; (vi) to develop new passenger transport lines; and (vii) to develop the small ports as significant regional development centres with diversified cargo flow. The LPDP also sets a number of target indicators to monitor the progress towards the achievement of the objective.\(^{20}\)

36. The LPDP underlines the importance of two multi-modal corridors: (i) overland shipment from China and Kazakhstan via Latvia to the EU (Baltics, Scandinavia and Germany) and (ii) transport by sea from China to the ports of Latvia and further to Moscow, the CIS countries, or the Baltic States. It also discusses secondary corridors, including (i) China, Korea, Japan – Trans-Siberia-Latvia-the EU, (ii) Asian goods going via the Black Sea (Ukraine) to the Baltics and Scandinavia through Latvia, (iii), Rail Baltica (a proposed entirely new standard-gauge line from Tallinn to Poland), and (iv) cargo from the EU and Asia transiting through Latvian ports to western Russia.

---

\(^{19}\) The fact that Latvian ports remain ice-free year round used to put them at an advantage over St. Petersburg and other ports in the Gulf of Finland. However, with recent warming trends and improvements in the technology of ice-breakers, Russia and Finland are now able to keep their ports open year-round.

\(^{20}\) It is worth noting that key quantified have been missed by a large margin (e.g., to increase cargo turnover to 100 million tons annually by 2013), which highlights the challenges faced by the ports.
2.2. Shipping Services

37. **Port competitiveness depends in part on the connectivity provided by regional and international shipping services.** This connectivity is measured in terms of frequency of services, transit times to major destinations, and freight rates. The relative proximity between the Baltic ports implies that location is less of a competitiveness factor than port capacity and efficiency. The principal distinction is the size of vessels used and the turnaround time in port. These affect the costs to be incurred by the shipping lines to serve a given port and are factored into the shipping line's freight rate and terminal handling charges. At this stage, Baltic ports all have similar characteristics in terms of draft and DWT (with Ventspils, Tallinn and Ust Luga designed for the larger bulk carriers and the other ports designed for moderate-sized vessels, cf. Table 8), but most of the ports have plans to deepen their access channels in order to accommodate larger bulk vessels and container vessels, specifically Aframax tankers, Capesize bulkers and Panamax container vessels.

| Table 8. Maximum Draft and Vessel Size (DWT\(^{21}\)) for Baltic Ports |
|-----------------|-------------|-------------|-------------|-------------|-------------|
| Draft (m)       | Riga        | Ventspils   | Klaipeda    | Tallinn     | St. Petersburg | Ust Luga |
| DWT             | 14.3        | 15          | 13.5        | 15 (16)     | 11           | 15        |
|                 | 85,000      | 125,000     | 75,000      | 125,000     | 40,000       | 125,000   |

38. **For bulk cargo, competitiveness tends to increase with the level of traffic.** Bulk cargo is the main specialization of the Latvian ports. Bulk carriers transport primarily full loads from the loading point in the Baltics to the destination ports in Northern Europe and elsewhere. Since bulk is typically shipped on charter vessels, the size of vessels and the frequency of vessel calls vary with the traffic levels. In effect, volume determines the level of service, which in turn determines competitiveness. In Riga, both vessel size and frequency of calls have been increasing. The same applies to the average amount of cargo transferred per vessel call as shown in Figure 12.

**Figure 12. Average Cargo Transferred per Call at Riga Port**

39. **Given the significant economies of scale in bulk shipping, the ability to serve larger vessels is a critical component of competitiveness.** This requires larger terminals with modern handling equipment in order to load the larger tankers in one day and the bulkers in 2-3 days. Ust-Luga has already developed facilities to provide this level of service to larger vessels and is expected to continue increasing its market share in oil and

\(^{21}\) Deadweight tonnage.
bulk. By contrast, Riga continues to emphasize its role as a bulk port but has been slow in executing plans to increase channel depth and develop modern bulk terminals. Ventspils is also planning to develop additional modern facilities to attract additional traffic.

40. **Containers are mainly transported by scheduled liner services operating on fixed routes** and, in most case, offering day-of-the-week service. Most of these are feeder services that transship the containers at the larger ports in Northern Europe (transit times to overseas destinations are hence similar). Each of the Baltic ports has multiple calls per day with competitive freight rates. Overall, Riga’s level of service is comparable to Tallinn’s and Klaipeda’s – but it is dwarfed by St. Petersburg.

### Table 9. Container Services in Baltics

<table>
<thead>
<tr>
<th>Weekly container Services</th>
<th>Total TEU 2012 (000s)</th>
<th>Weekly Services</th>
<th>TEU per Call</th>
<th>Total calls at other ports</th>
<th>Density* (TEU/connection)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Riga</td>
<td>362</td>
<td>11</td>
<td>625</td>
<td>38</td>
<td>183</td>
</tr>
<tr>
<td>Klaipeda</td>
<td>382</td>
<td>15</td>
<td>490</td>
<td>55</td>
<td>133</td>
</tr>
<tr>
<td>Tallinn</td>
<td>227</td>
<td>9</td>
<td>487</td>
<td>29</td>
<td>151</td>
</tr>
<tr>
<td>St. Petersburg</td>
<td>2,525</td>
<td>39</td>
<td>1,245</td>
<td>132</td>
<td>369</td>
</tr>
</tbody>
</table>

* 2012 container volumes (TEU) divided by theoretical amount of port calls on routes serving the port

**Source:** Baltic Transport Journal Database

41. **Container vessels calling at the Baltic Ports are increasing in size.** At present, the average size of the container vessels is less than 1,000 TEU and most of the ports handle less than 500 thousands TEU per year. However, an increasing share of these vessels now has over 1,200 TEU capacity. The average vessel size is expected to increase significantly in the short-to-medium term as the shipping lines reallocate their fleets to allocate Sub-Panamax vessels to the Baltic feeder routes while using larger vessels on their main routes. The majority of the East Baltic ports have therefore plans to increase their capacity for handling unitized cargo (containers and/or RoRo): this has already occurred in St. Petersburg, where Maersk is involved in terminal operations and Klaipeda where MSC is constructing a new container terminal to be used for transshipment (these ports will be equipped with Post Panamax SSGs able to handle their 4-5,000-TEU vessels). In contrast, Riga’s container terminal was constructed in the 1970s and still has its original ship-to-shore gantry cranes (SSG). To be prepared for handling larger-size container vessels, Riga’s container terminal needs an increase in depth and length along with an upgrade of the SSGs and yard equipment.22

### 2.3. Land transport

42. **Landside connectivity is important for the competitiveness of the Baltic ports** – by rail for bulk cargo and by road for containerized goods. Differences in distances between the Baltic ports and the major inland origins/destinations are relatively small in a number of cases (see Table 10) for distances up to 1,500 km and the transit times and service reliability are similar. Riga and Klaipeda have an advantage for movements to/from Kiev and Minsk, but St. Petersburg and Ust Luga have an advantage for cargo to/from Moscow and Nizhni Novgorod.

### Table 10. Distances from Ports by Road*

<table>
<thead>
<tr>
<th></th>
<th>Riga</th>
<th>Ventspils</th>
<th>Klaipeda</th>
<th>Tallinn</th>
<th>St Petersburg</th>
<th>Ust Luga</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minsk</td>
<td>484</td>
<td>+162</td>
<td>+10</td>
<td>+308</td>
<td>+307</td>
<td>+291</td>
</tr>
<tr>
<td>Moscow</td>
<td>+211</td>
<td>+393</td>
<td>+477</td>
<td>+329</td>
<td>715</td>
<td>+114</td>
</tr>
</tbody>
</table>

---

22 It has been reported to the authors of the report at a late stage of the study that the cranes have been modernized in recent years and a new bigger SSG is planned to be delivered in 2014.
43. **Road transport costs are very competitive relative to railroads for distances up to about 800 km.**
This advantage extends up to 1,000 km when taking into account the benefits of flexibility and reduction in door-to-door times. For example, most containerized imports from China (including Western China) travel by sea through Suez and up to the Baltic ports and then continue by road to Moscow. This route is somewhat slower but more reliable and less expensive than the all-rail movement through Russia.

44. **Improved quality of service, volumes and reliability have favored Latvia’s competitors for road bound traffic.** Road transport is the main land mode on routes that circumvent the Baltic ports. For example, a significant share of high value imports from Northern Europe to Moscow and Belarus are shipped by road through Finland (for Moscow, even if its market share is affected similarly to Latvian Ports) and Poland (for part of Russia and Belarus), because these routes offer comparable door-to-door cost but greater reliability and flexibility. The fact that both routes are still competitive compared to Baltic Ports can be explained by the size of the logistics industry, coming from an initial very large economic size of the domestic market compared to Latvia - 15 times for Poland, 8 times for Finland. This translates into a much larger logistics markets. The logistics industry can balance its services between domestic and external trade and benefit from economies of scale that impact costs and prices. Both countries also adopted in the 2000s an aggressive policy to develop their positions with other EU countries. In the case of Poland, the trucking and logistics industry saw opportunities to develop by accessing the Western EU markets in a context where they could benefit from loads in both directions due to the combination of its own domestic exports and import needs. They also realized that they could compete beyond bilateral and transit trade given the structure of the industry in Western Europe if they could match their reliability. The results of these incentives also indirectly improved the quality of their services towards the East. Unfortunately Latvia’s position is substantially different and benefit neither from the same stimulation of competition on the land side nor from the possibility of diversification of traffic offered by the Polish market.

45. **Road transport accounts for a relatively large share of port cargo.** Cargo transported by trucks includes containers and RoRo cargo, as well as timber, building materials, metals, and peat. Data for the terminals in Riga indicate that about 24 percent of the total cargo is transported to/from the ports by trucks. This includes all of the general cargo and about 10.5 percent of the bulk cargo, especially grain and oil products. However, there are major bottlenecks to the terminals in Riga related to the congestion in the city, at railway crossings, and at bridges over the River Daugava.

46. **Railways carry most of the traffic from / to Latvian ports** (see Table 11) – including coal and oil products. Rail connectivity is extremely important for the movement of bulk cargo and for the long-distance transport of container cargo. For bulk cargo, most of the rail freight is low-value, and the cost of land transport has a significant impact on routing decisions and the selection of the loading port. In this regard, St Petersburg, Ust-Luga and Primorsk benefit from their proximity to major origins/destinations relative to Riga and Ventspils. For container cargo, transit time and reliability are critical parameters in selecting a route.

---

<p>| | | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kiev</td>
<td>1,060</td>
<td>+161</td>
<td>+9</td>
<td>+306</td>
<td>+380</td>
</tr>
<tr>
<td>Nizni Novgorod</td>
<td>+228</td>
<td>+410</td>
<td>+494</td>
<td>+344</td>
<td>1126</td>
</tr>
<tr>
<td>Odessa</td>
<td>1,532</td>
<td>+161</td>
<td>+9</td>
<td>+307</td>
<td>+381</td>
</tr>
</tbody>
</table>

*Shortest in bold, other distances as increments over the shortest

---

23 Latvian Railways is responsible for development and maintenance of the basic network. There are three railway companies operating in Latvia, the National railways and two private train-operating companies, Baltijas Ekspresis and Baltijas Tranzita Serviss. The private operators account for 22 percent of the total ton-km.
Table 11. Rail Freight by Ports, Million Tons

<table>
<thead>
<tr>
<th>Ports</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012*</th>
<th>Share of Railways vs. total traffic, %*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>43.9</td>
<td>45.1</td>
<td>39.1</td>
<td>47.7</td>
<td>49.2</td>
<td>69.7</td>
</tr>
<tr>
<td>Ventspils</td>
<td>18.6</td>
<td>19.2</td>
<td>15.0</td>
<td>19.9</td>
<td>19.9</td>
<td>69.8</td>
</tr>
<tr>
<td>Riga</td>
<td>22.9</td>
<td>23.8</td>
<td>22.1</td>
<td>25.5</td>
<td>25.8</td>
<td>71.5</td>
</tr>
<tr>
<td>Liepaja</td>
<td>2.4</td>
<td>2.2</td>
<td>1.9</td>
<td>2.3</td>
<td>3.4</td>
<td>56.7</td>
</tr>
</tbody>
</table>

*Share of rail traffic in a certain port of total rail traffic going through the three main ports

Source: Baltic Transport Journal

47. Transit cargo moving through the ports accounts for about 80 percent of the rail freight in Latvia. About 60 million tons of freight were transported by Latvian Railways in 2012, an increase of 50 percent over the last decade. Approximately two thirds of rail freight came from Russia and one quarter from Belarus.

Figure 13. Railway Cargo in Latvia

Figure 14. Rail Freight by Commodity & Country

48. Capacity bottlenecks on the railway network could become a limiting factor to the development of Latvian ports. The current level of traffic is close to the network’s freight capacity which is estimated at 70-75 million tons (it has already been necessary to allocate slots according to the annual volumes
requested by the major shippers). A number of investments have been proposed to increase the capacity by 2015, including: (i) double tracking selected sections of the network to increase throughput to 140 trains per day; (ii) electrifying the high-density lines connecting the ports of Riga and Ventspils to the locomotive transfer points for trains from Russia (Rezneke) and Belarus (Daugavpils); and (iii) introducing new signaling. Nevertheless, the availability of funding remains uncertain as it depends partly on the allocation of EU structural funds to the transport sector by the Latvian government.

49. **Railway access is also congested in the port of Riga.** The railway branches providing access to the port terminals are owned by the Latvian Railways, the port and some of the terminals, but all of the train movements are controlled by the Railways. There are already serious delays in shunting trains from the port train stations to the terminals, because each of the branch lines serves multiple terminals. With the implementation of new terminals on Kundziņsala and Krievu Sala, congestion will increase and the need for additional access capacity will become critical.

50. **Increasing throughput in Latvian ports (traffic volume) will also require developing reliable block train operations from the inland origins/destinations of the cargo.** This requires not only adequate capacity in the Latvian network and provision of efficient line-haul and shunting services by the Latvian railways, but also effective integration with railway service providers in the countries to the East of Latvia. Reliability is currently not a significant problem except for shipments of less-than-train loads which do not use unit trains. For these, the uncertainty in transit time is due to the time lost when passing through classification yards. The costs for land transport to/from the individual ports are affected by distance but more important factors are the availability of wagons and backhaul cargo.

51. **The current transition from publicly provided railway services to private operations and the unbundling of the former CIS Railways has created both opportunities and challenges.** The opportunities are associated with the ability to initiate block train operations for specific cargo or Origin/Destination (O/D) pairs, such as the current container block train operations which serve several CIS countries from Riga. The challenges include securing rolling stock now that the common pool of wagons available in the CIS has been transferred to private operators. They also include mitigation of the significant and unpredictable fluctuations in the cost of rail transport, as the system-wide pricing strategies of the national railways are replaced with pricing strategies for individual services offered by private or national public operators. Fluctuation of pricing by private operators probably reflects the scarcity of railway capacity in different periods and routes. It gives a signal for commercially run track operators to invest in new railroads and for new operators to challenge the existing ones with more aggressive pricing. In the end competition would smooth prices.

52. **There has been progress in reducing border crossing times with Russia and Belarus,** thanks to progress made by relevant agencies of both countries (customs, immigration, etc.) – although there remains room for improvement. The overland corridor joining Russia and Latvia suffers from congestion and delays at the border in the case of road transport, but rail cross-border movements, mostly large bulk shipments by long-established clients, generally go smoothly.24 Within the context of accessing the WTO, the Russian railways have gradually phased out their past practice of charging higher rail tariffs to goods crossing the country’s borders to use foreign ports (compared to those directed to Russian ports).

---

24 For international movements, there are three main crossing points – two for Russia and one for Belarus, with a capacity of respectively 47 and 38 trains per day in each direction (for fully loaded trains, one train per day amounts to about 1 million tons of freight per year.) and one for Belarus (with a capacity of 38 trains per day in each direction). The time to cross the border is reduced by allowing the trains to enter Latvia and transfer the locomotives at Rezneke and Daugavpils. The Port of Riga is connected to the East-West corridor operated by the Trans-Siberian Railway (TSR). Three container block trains services connect the port of Riga to Odessa, Almaty (CIS) and Moscow, with sufficient volumes to have multiple movements per week (only the Almaty service operates on a fixed schedule).
Recommendations

53. *The Government should further strengthen coordination in planning investments, reforms, and process improvements across the logistics chain.* Port cargo use a relatively small number of land transport corridors in Latvia, and efforts to improve services could hence be articulated within the context of corridor management. Corridor management includes not only the development and maintenance of transport infrastructure but also the development of intermodal nodes, harmonization or regulations and coordination of border inspection clearance procedures. This approach should be reflected in the upcoming strategic documents for the 2014-2020 period.25

54. *The Government should ensure that the ports’ and the railways’ development plans are integrated* with a view to ensuring unhindered access to the designated sites and sufficient capacity to serve these clusters and the principal markets served by these clusters. Ports and other transport agencies (railways, road transport agencies, border-crossing and other agencies) also need to closely collaborate in the collection of performance data in order to timely identify bottlenecks.

55. *The Boards and Management of the ports should plan and mobilize funding for investments aimed at enabling calls by larger vessels.* This is especially important for Riga, for both bulk and container cargo.

56. *The Government should plan and secure funding for investments in the railways sector,* especially to increase freight capacity and remove bottlenecks around the Riga port. To help the Riga port increase container traffic, it is also important to address the need for better traffic separation and greater capacity on the urban road links connecting the port, and the major road corridors. Given the size of investment required in rail, and to the fact that it is the main focus of the next EU perspective as a clean mode of transport there is likely to be a strong preference for rail investment in the next period and this implies that ports need to find other sources for their own investment.

---

25 These documents could benefit from a detailed analysis of the key factors behind changes in the traffic. These may include not only the normal determinants of port choice, namely port tariffs and cargo handling efficiency, but also the role of tie-ups with cargo owners (for example, Zarechnaya and the Vitol Group at Ventspils) which provide guaranteed traffic for terminals, and the analysis of the rest of the supply/logistics chain.
3. Pricing policy and sustainability of ports development

57. In an environment of fierce competition, Latvian ports have significant investment needs. Latvian ports are financially self-sufficient: they do not pay corporate income tax or dividends to the Government, and they do not receive government funding. However, the ports have benefited from public support, through the allocation of significant amount of resources from EU Cohesion Funds (which could have been used in other sectors). With their resources, the ports are responsible for providing, maintaining, upgrading and modernizing infrastructure to keep up with demand and changes in the market. This specific tax regime which has been consistent with practices in many ports has allowed Latvian ports as non-profit organizations to reinvest their surplus.

58. A recent amendment to the Law has resulted in the introduction of a new tax on Latvian ports to give a contribution to the State Budget for the use of strategic infrastructure. The ports are to pay 10 percent of the fees that they receive for handling cargo, small ships and anchorage. This tax is similar to the one that the ports already pay to the respective local governments. Some stakeholders would like the ports to contribute more to the budget through additional contributions from their revenue. Although ports use commercial accounting systems similar to the one used by private companies, due to the commercial nature of their operations, port authorities are “derived public persons“, but not public companies by Law. For example, they cannot distribute or pay dividends given that profit is not allowed by Law and such “derived public persons” cannot pay corporate income tax considering because they are not corporations (for further discussion on the legal framework of Latvian ports, cf. Chapter 5).

59. In the context of higher taxation, the Boards and managements of the Ports face a challenge: to generate a surplus which is sufficient to finance the necessary investments. This requires setting adequate tariff policies, managing the level of expenditures, assessing investment needs, and finding options to match such needs with the necessary resources.

3.1. Revenues and pricing policy

60. Port tariffs can be divided into two categories of fees and charges. Fees are based on the perceived value that a shipper or vessel derives from using a port and its facilities. Charges are based on the quantity of services requested by the port user or resources provided by the port.

Box 4. Pricing policies

| Fees commonly included in port tariffs include channel dues (also light dues) associated with the entry to the port area, port dues associated with access to the harbor and its facilities and, and cargo dues (wharfage) based on the value of the cargo transferred between the vessel and the land. Channel dues are based on ship dimensions (length overall, draft, or gross tonnage). Port dues are generally calculated based on the size of the vessel (gross tonnage, net registered tonnage, length x beam). Cargo dues were originally in the form of an ad valorem tax but have been simplified to unit charge counter with the rate differentiated by form of cargo and by commodity. The design of fees has evolved relatively slowly over the last centuries from the days when ports were municipal wharves under the jurisdiction of the customs and excise department. |

---

24 The ports pay some taxes, including VAT and land tax.
27 http://www.baltic-course.com/eng/transport/?doc=83414
28 External audits in Latvian ports are carried out in accordance with International Standards for Auditing 810, “Engagements to Report on Summary Financial Statements. International Standards for Auditing are applicable to all corporations using International Financial Reporting System (IFRS) or similar commercial accounting systems unless the host government makes a case.
Charges are commonly levied for berth hire, mooring/unmooring, stevedoring and wharf handling, storage, utilities, as well as a long list of optional services. These charges are based either on the quantity of cargo (metric tons, TEU) or the amount of resource (meters of wharf, gangs, cubic meters, etc.) The introduction of containers in the 1960s, led to a dramatic simplification (based largely on concepts introduced by the Port of Singapore). A further simplification occurred in the late 1990s with the introduction of terminal handling charges (THC) which allowed off-setting charges to be levied by the terminal operator on the shipping lines and by the shipping lines on the cargo owners.

The introduction of the landlord port model led to a division in the tariffs with the public port continuing to collect the fees and the private sector service providers collecting the charges. The port also collects payment from the service providers usually set out in a lease or concession agreement. This payment is based on the amount of resources provided by the port (typically an annual land rental) but also often includes a fee based on the amount of cargo handled (a royalty). Efforts to introduce cost-based pricing have been largely unsuccessful worldwide.

61. In Latvia, port fees constitute the major source of revenues. The structure of revenues varies significantly across ports worldwide, and there is no clear “international practice”. For both Latvian ports, the income sources comprise port dues, land lease fees, real estate lease fees, and income from services. Fees based on the size of vessels account for about 80 percent of port revenues in Riga and about 70 percent of port revenues in Ventspils (another fee based on the amount of cargo handled accounts for an additional 5 percent of revenues in Ventspils). Land leases account for a relatively small share of the total revenues (less than 5 percent in Riga, about 10 percent in Ventspils). Some critical investments in Ventspils have benefited from contributions from the EU Cohesion Fund grants and some in Riga are yet to benefit (cf. Section on Surplus and investment capacity).

Figure 15. Sources of Revenues in Ports of Riga and Ventspils

62. The Latvian Ports’ revenue structure presents several characteristics which may negatively affect their financial sustainability:

- **Relying on vessels size-based dues is usually considered sub-optimal.** Such fees are based on gross tonnage so that the vessel and ultimately the shipper are being charged for the size of the vessel rather than the amount of cargo transferred. This used to be a standard practice throughout the world but cargo based charges have progressively gained importance: the vessel size-based
The system may discourage shipping lines from introducing larger, more efficient vessels that would provide a better level of service or new lines from calling at the port unless they have sufficient cargo to cover charges.  

- **The share of revenues from land use (leases) is very low, especially in Riga.** This is due to a series of historical reasons, and is aggravated by the long duration of lease agreements (typically 45 years with an automatic renewal).

- **The reliance on EU funds for investment will create challenges.** Self-sufficient ports are expected to finance their investments from their own revenues, rather than public resources. The use of EU funds to finance ports also has an opportunity cost for the country and the economy at large. Under the new Financial Perspective, it is likely that the availability of large amounts of EU resources will be reconsidered, especially for investments in the ports themselves, given the EU priority for environment-friendly transport, rail and the needs on the rest of the logistics chain.

63. **Latvian Ports’ pricing policy is dictated by a mix of competition and history.** Fees and charges reflect the Ports’ competitiveness position: both Ports have adopted a similar pricing strategy utilizing tariff formats which are comparable to those of competing ports even if the level of individual tariff varies a lot, and rates which are among the lowest in the region when all individual tariffs are aggregated per ton or vessel. Land leases have been set out in long-term contracts, which cannot be renegotiated easily. As in many other ports worldwide, it is not clear that the ports have updated pricing and elasticity models which can be used to assess the potential revenue and market share impacts of various pricing policies, and this may be resulting in “missed revenues”.

64. **Efforts to maintain competitive tariffs have resulted in keeping revenues relatively low.** This is the case both in Riga and in Ventspils. Revenues stood at Euro 49 million in Riga and 24 million in Ventspils in 2011, with revenues per ton (at Euro 1.36 and Euro 0.79 respectively) among the lowest in the region (see Table 12). This reflects the strategy by both Ports to maintain an aggressive pricing policy in order to remain competitive.

### Table 12. Comparison of Port Charges and Share of Surplus Generated by Ports

<table>
<thead>
<tr>
<th></th>
<th>Rotterdam</th>
<th>Antwerp</th>
<th>Tallinn</th>
<th>Klaipeda</th>
<th>Ventspils</th>
<th>Riga</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
<td>2010 (a)</td>
<td>2013 (b)</td>
<td>2013 (b)</td>
<td>2011</td>
<td>2011</td>
</tr>
<tr>
<td>Revenues, Euro Mn</td>
<td>615</td>
<td>307</td>
<td>110</td>
<td>46</td>
<td>24</td>
<td>49</td>
</tr>
<tr>
<td>Costs(^{30}), Euro Mn</td>
<td>344</td>
<td>242</td>
<td>51</td>
<td>n.a.</td>
<td>12</td>
<td>37</td>
</tr>
<tr>
<td>Surplus, Euro Mn</td>
<td>271</td>
<td>65</td>
<td>59</td>
<td>n.a.</td>
<td>11</td>
<td>12</td>
</tr>
<tr>
<td>Mn Tons handled</td>
<td>442</td>
<td>178</td>
<td>30</td>
<td>40</td>
<td>30</td>
<td>36</td>
</tr>
<tr>
<td>Euros/ton</td>
<td>1.39</td>
<td>1.72</td>
<td>2.06 (c)</td>
<td>1.16</td>
<td>0.79</td>
<td>1.36</td>
</tr>
<tr>
<td>Surplus as % of total revenues</td>
<td>44%</td>
<td>21%</td>
<td>53%</td>
<td>48%</td>
<td>24%</td>
<td></td>
</tr>
</tbody>
</table>

---

\(^{29}\) Ventspils is trying to address this issue by reducing the port dues for RoRo vessels in order to increase its market share.

\(^{30}\) All ports, including competing Baltic ports, have different structure of fees, which means that some ports charge high for some tariffs but low for others. Thus, the most common approach used to provide a comparison of port fees in ports is total revenues divided by total tons handled.

\(^{31}\) For example the ports use cadastral value to set lease rates (while they could sometimes use regional market rates). Royalties follow various patterns, sometimes a fixed amount based on a guaranteed cargo equivalent (which de facto has the same effect and predictability as a land lease), sometimes tonnage based royalties. The rationale for using one, the other or a combination of both is not established.

\(^{32}\) Values do not separate passenger and cargo traffic but in the case of both Riga and Ventspils the proportion of passenger activity is limited enough for these proxies to be relevant.

\(^{33}\) Costs include depreciation, but not investments.
(a) Antwerp’s accounts after 2010 reflect large provisions to cover new pension legislation.
(b) First half of 2013 X 2
(c) Revenues in Euro/ton is calculated for Tallinn without passenger revenues which represent Euro 42 Mn (or around 38 percent of total revenues)) and without electricity sale revenues which represent Euro 6.5 million (the data for 2012 was used to get a rough estimation).

Figure 16. Total Traffic Volume Handled and Revenues Generated by Riga and Ventspils

3.2. Expenditure

65. While operating costs seem relatively high, the two Ports are facing different challenges:

- **In Riga**, revenues have risen steadily but costs have risen faster over the past few years. In 2011, they stood at about Euro 37 million. Operating expenses are relatively high, with an operating ratio at over 75 percent34 and highest average monthly salary among competing ports. Unless there are some specific issues in the detailed cost structure of the Port, the traffic evolution in Riga should have led to a significant decrease in this ratio. Depreciation costs are low (many of the port facilities are fully depreciated), and labor costs remain within standards (at about 42 percent of operating costs exclusive of depreciation, although increasing). This suggests that a better control of operating costs is probably required.35 An operational audit (as proposed in Section 7) would be a possible way to know more about the potential for cost savings.

- **In Ventspils**, revenues have declined slightly, but costs have fallen faster over the past few years. In 2001, they stood at about Euro 12 million. The operating ratio (at 64 percent) remains relatively high, similar to Riga’s, for a landlord port (this can be partly explained by the substantial depreciation costs for the relatively new facilities). The working ratio at about 39.5 percent is in line with comparators (e.g., Tallinn, Rotterdam).36 Labor costs stand at about 45

---

34 Operating ratio is defined as the amount of operating expenses divided by the amount of net sales. The smaller the ratio, the greater the organization’s ability is to generate profit if revenues decrease.
35 No detailed cost elements were provided by the Freeport of Riga, which makes it impossible to provide more detailed diagnosis of operating costs and recommendations.
36 Working ratio is defined as the amount of expenses divided by the amount of revenues. Unlike in operating ratio, depreciation and debt is subtracted from expenses before this calculation is done. The higher the ratio, the greater capability to recover expenses from revenues is.
percent of operating costs, exclusive of depreciation. The return on fixed assets is low, due to the port’s difficulties in attracting cargo.

Figure 17. Revenues and Average Monthly Salary per Employee in Major Baltic States’ Ports

(a) Revenues per employee

(b) Average monthly salary per employee

(a) Revenue per employee for Tallinn is calculated without passenger traffic and electricity sale revenues.

* - Average number of workers in a respective port authority.

Source: KPMG Baltics SIA. Competitive Position of Baltic States Ports, November 2013

66. Both Ports are likely to have room for efficiency gains and cost reduction, especially Riga. Efforts should be made to achieve such gains, as part of the overall effort to strengthen competitiveness (and build space to absorb potential shocks and increase investment capacity) and more generally as a sign of good management. A simple comparison of the latest financial reports for the eastern Baltic ports indicates that Latvian ports have significantly lower revenues per employee, lower cargo turnover per ha, and significantly higher average salary per employee. Additional cost data could further specify the areas for efficiency programs including quick wins and areas with potential gains.

Table 13. Financial Ratios in Ports of Riga and Ventspils

<table>
<thead>
<tr>
<th></th>
<th>Riga</th>
<th>Ventspils</th>
<th>Riga</th>
<th>Ventspils</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2011</td>
<td>2010</td>
<td>2011</td>
<td>2010</td>
</tr>
<tr>
<td>Operating Ratio</td>
<td>75.8%</td>
<td>77.8%</td>
<td>64.0%</td>
<td>65.7%</td>
</tr>
<tr>
<td>Working Ratio</td>
<td>63.5%</td>
<td>64.0%</td>
<td>39.5%</td>
<td>42.0%</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>23.2%</td>
<td>21.6%</td>
<td>34.4%</td>
<td>29.6%</td>
</tr>
<tr>
<td>Return on Capital Employed</td>
<td>5.1%</td>
<td>4.3%</td>
<td>3.8%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Return on Net Fixed Assets</td>
<td>5.6%</td>
<td>4.8%</td>
<td>3.4%</td>
<td>2.9%</td>
</tr>
<tr>
<td>Debt-Equity</td>
<td>6.3%</td>
<td>7.5%</td>
<td>0.21%</td>
<td>0.27%</td>
</tr>
<tr>
<td>Receivables (in number of days)</td>
<td>31</td>
<td>47.43</td>
<td>12</td>
<td>12</td>
</tr>
<tr>
<td>Cash flow + investment-net increase in loans (mn LVL)</td>
<td>14.49</td>
<td>9.73</td>
<td>11.09</td>
<td>16.60</td>
</tr>
</tbody>
</table>
3.3. Surplus and investment capacity

67. Under their current status, Latvian ports are required to invest their surpluses back into the port. Ports do not pay dividends to the Government or municipal authorities (due to their legal status), but are expected to be financially self-sustaining. Such an approach is common (though by no mean generalized) across the world: subsidies from government and international agencies, which had been common, especially for dredging and breakwaters, but also for other infrastructure, have been largely phased out, and part of the burden of port investment has been passed to the private sector.

68. Investments in infrastructure made by Latvian ports have been lower than that by their Baltic competitors in the past few years (Figure 18). Low surplus (cf. Table 12 and Figure 19) in Latvian ports can explain such lower levels of investments. During the last ten years Freeport of Ventspils Authority has invested more than 107 million LVL, out of which 15.8 million LVL has been supported by EU Cohesion Fund. During the same period of time, Freeport of Riga Authority has invested more than 81 million LVL. In 2013 the Freeport of Riga Authority has received EU Cohesion approval to support Krievu Sala project which aims at new territory development and removal of port activities out of the city center. Total investment costs for Krievu Sala project are estimated at 104.86 million LVL out of which 54.24 million LVL will be covered by EU Cohesion Fund. In addition to EU Cohesion Fund grants, Latvian Ports have also used private sector resources for terminal developments (especially in Ventspils).

Figure 18. Port Investments in Infrastructure in Baltic States in 2010-2012, EUR Million

Box 5. International Practices of Financial Flow between the State and Ports

Historically, there were significant financial flows from governments to ports, rather than vice versa. Governments in many countries subsidized their ports, particularly, for dredging and breakwaters. Europe’s top ports – Rotterdam, Antwerp and Hamburg – used to receive larges subsidies because the ports were regarded as vehicles to stimulate the local economies. In recent years, however, governments are increasingly requiring ports to be financially self-sufficient. Only about 5 percent of EU ports’ revenues now come from public funds, with about half coming from port dues and a quarter from

37 Dividends are only paid by companies; Latvian ports are derived public persons and not companies.
leases/rents (ESPO). Rotterdam, Antwerp and Hamburg still have their dredging subsidized by local governments.

Internationally, ports’ main contribution to governments is via (a) taxes, and (b) dividends. While Latvian ports pay only land tax and VAT, other ports in Europe pay different types of taxes: 54 percent of them pay income taxes, 82 percent VAT, 57 percent local taxes, and 27 percent other taxes (only 6 percent pay no taxes). There are significant variations across ports and countries.

In the EU, the shareholders or owners to whom the dividends are paid are the state governments (40 percent), municipal governments (35 percent) and others (25 percent), who own ports which have been incorporated under Commercial Law or Law on public corporations. Ports that pay significant dividends include Rotterdam, Antwerp, and Tallinn.

69. **The surpluses**\(^39\) **of Latvian Ports are relatively small in absolute terms.** In both ports, surpluses have been severely affected by the combination of the financial crisis in 2008 and of the emergence of new competitors in Russia. Since then, and with ups and downs, Riga’s surplus has hovered around Euro 12 million and Ventspils’ around Euro 8 million per year.

**Figure 19. Surplus in Latvian Ports (Euro million)**

![Surplus in Latvian Ports (Euro million)](image)

70. **By comparison, investment plans are very large.** Riga, as an older port, is in need of upgrading and modernizing its infrastructure, while Ventspils lacks serviceable land\(^40\) for further development. Investment plans have been developed by both Ports to address these issues, with a cost reportedly estimated at Euro 60 million for Ventspils, and at around Euro 305 million for Riga (for the period of 2012-2017). The figure for Riga’s investment needs is significantly above what could be financed from the current levels of profit. The current level of surplus may be adequate for Ventspils to finance its investments plans and Ventspils’ investment needs are significantly lower than Riga’s.

---

\(^{39}\) Surplus is defined as revenues minus costs.

\(^{40}\) “Serviceable land” is land that could immediately be serviced (could be used in service), without being developed before given for use/service, or land which is immediately ready for service/use without its prior development.
Table 14. Planned Investments in Riga

<table>
<thead>
<tr>
<th>Project</th>
<th>Cost 2012-2017 (Euro million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Krievu Sala</td>
<td>184</td>
</tr>
<tr>
<td>Channel dredging</td>
<td>71</td>
</tr>
<tr>
<td>Breakwaters</td>
<td>21</td>
</tr>
<tr>
<td>Kundzinsala railway</td>
<td>19</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>295</strong></td>
</tr>
</tbody>
</table>

71. **However, the actual investment needs and costs are difficult to assess.** The Latvian ports do not have an established methodology to evaluate actual investment needs (see Box 5). There is no target rate of return against which to evaluate investments. The ports use a weighted average cost of capital and calculate Financial Internal Rates of Return (FIRRs) or Economic Internal Rates of Return (EIRRs), only when requesting funds from the EU Cohesion Funds, where such indicators are required. Consequently there is no economically based method of establishing whether an investment is justified (except for the EU funded projects). There are also uncertainties over the expected costs of the specific investments that are being considered.

Box 6. Investment Appraisal in Ports

Most ports have fairly rigorous approaches to investment appraisal. Historically, the main focus of investment appraisal in ports was often on economic evaluation, which compares the costs and benefits of the proposed investments from the viewpoint of national economy, to derive an EIRR. It is to be distinguished from the financial analysis that compares the revenues and expenditures of the proposed projects from the viewpoint of the investors, to derive a FIRR. In most of the port feasibility studies the majority of the economic benefits of port construction – for example, reductions in ships’ queuing costs and faster ship turn-around times with faster equipment – do not appear in the accounts of the port authority or in the financial analysis. Similarly, the financial revenues to the port cannot be counted as net benefits to the national economy, as they are cancelled out by the charges made by the shipping lines to recover them from importers and exporters.

Ports (and their lenders) normally require target rates of return to justify investments. After the investments are completed they set their tariffs to make, in broad terms, a required rate of return on their assets. These principles are not always applied rigorously, but are generally accepted. A good example is seen in the approach recommended by the UK government for their Trust Ports. The Trust ports should be run as commercial businesses, seeking to generate a surplus which should be invested back into the port, or otherwise directed towards the interests of the port's stakeholders. The Government expects the trust ports to generate a commercially acceptable rate of return. A target level of return is set in line with the Treasury's recommendation of 6 percent for public sector services and 8 percent for publicly provided commercial services with a discount rate equivalent to 3.5 percent in real terms. The Ports of Sydney applies almost a similar discount rate – 3.06 percent - and also sets a similar rate of return on assets – 8.6 percent. Other ports require higher returns: the South African ports have been trying to base their tariffs on a very high weighted average cost of capital (13-14 percent).

---

41 In these cases the analysis is done by consultants. The discount rate used for bringing financial revenues and expenditures back to present values is 5 percent and for economic evaluation 5.5 percent. These are set by the EU template for analysis, as the port authorities do not set their own test discount rate.


43 The target level of return should reflect the need to provide a surplus for contingency and, in addition, take account of the level of risks associated with any particular investment. The risk premium is important since bulk traffics are often highly volatile especially for transit cargo whereas the risk premium for containers is low if domestic but high if transshipment.
72. **In any event, the recent source of financing for investments may be insufficient in the coming period especially for Riga.** The Latvian ports benefited from substantial EU funding during the 2007-2013 programming period that are currently being used for Krievu Sala in Riga for example, but access to such funds is expected to become more difficult for the ports under the upcoming Financial Perspective. Terminal operators have also been constructing and funding their own quays (in exchange for lower lease charges), but the investments which are now being considered (e.g., dredging, breakwaters) are typically not of direct interest to private investors, or are precisely aimed at developing the infrastructure needed to attract investors (e.g., Krievu Sala).

73. **Most modern ports finance their investments in part through borrowing.** Ports use their surplus to expand, and when necessary, they borrow on the strength of their balance sheets and forecast incomes. In the case of Riga, the port could afford to increase its borrowing (because of its low debt-equity ratio and high debt service coverage ratio), but this would still be insufficient to support all planned investments. In the case of Ventspils, the room for increased borrowing is more limited, but investment needs are lower, which means that the Port may be able to finance its investment needs.

74. **To finance their needs in a sustainable manner, the ports have three levers** (which should be used in combination):

- **Reduce operating costs**, in order to increase the available surplus. While the financial gains may be limited, it would provide a strong signal of the ports’ commitment to maintaining their competitiveness. This could be achieved through a mix of productivity gains and tighter financial control systems.

- **Prioritize investments**, and promote low-cost solutions. In a context of limited financial resources, the selection of investments to be funded is critical. This should be based on a sound economic and financial appraisal methodology.

- **Increase tariffs.** A simple calculation suggests that in order to cover 75 percent of its investment needs over the next 15 years, Riga would need to increase its tariffs by 18 percent. This would obviously affect the port’s competitiveness.

75. **Because competitiveness depends on more than prices, the Ports may have some flexibility in their pricing policy.** In a very competitive environment, price-sensitive operators will make decisions based on the costs of the whole supply chain, of which ports costs are typically less than 10 percent of the total (of which less than half in charges due to port authorities). Detailed elasticity studies (typically part of marketing studies for the main commodities handled by the ports) would be needed to determine the likely impact on traffic (and hence on total revenues) of an increase in port tariffs. As the elasticity tends to be high in the case of low value cargo, which is the main business of Riga and Ventspils, the room for tariff increases is limited.

---

44 The cash generated in 2011 and available for investment (EBITDA) was only about Euro 21 million. Assuming (i) a capital recovery factor (CRF) of 0.15; (ii) an annual growth in cash generation of 6 percent (a very optimistic assumption); and (iii) an allowance of Euro 6 million for renewals and other investments, the capacity to invest in infrastructure in the medium term would be about Euro 165 million, still significantly below the needs.

45 Assuming (i) a capital recovery factor of 0.15, (ii) revenue growth of 5 percent a year; and (iii) Euro 4.5 million for renewals and other investments, the cash flow available for investment would support only an investment of about Euro 58 million, which is close to the needs estimated at Euro 60 million.

46 The assumptions include (i) investment needs of Euro 295 million (including Krievu Island project), (ii) revenues and costs used for calculations were based on 2011 accounts; (iii) growth of revenues at 5 percent a year, (iv) growth of costs at 4 percent a year, and (v) discount factor of 10 percent. If Krievu Island is excluded, tariffs could be increased by 13 percent to cover 75 percent of Riga’s investment needs over the period of the next 6 years (using the same assumptions (ii) through (v)).
3.4. Taxation and dividends

76. During the time of this study, there was a debate in Latvia on whether to tax Riga and Ventspils Ports (beyond the VAT and land taxes which are already applied). It resulted in introduction of a new tax on Latvian ports to pay to the State Budget (for the use of strategic infrastructure), similar to the tax they pay to the municipal budget.47 At a time of fiscal consolidation, the specific regime of the ports is being challenged. During that debate, some observers also noted that the competing port of Tallinn is paying substantial dividends to its main shareholder, the Estonian Government. However, this is mainly possible due to the legal status of the Port of Tallinn, which is a public company under law on public corporation, while Latvian ports are not companies and are under public law.

77. A number of transport economists recommend against taxing landlord ports. Any tax to be paid by a port authority is reflected in charges on port users, which has a clear impact on the port’s competitiveness. Even from a fiscal perspective, the lower a port charges, the more revenues port users generate which in principle can be taxed later. There is an exception for ports which are natural monopolies as they can generate significant profits which the governments should tax – but this is not the situation in Latvia.

78. In Latvia, the case for new taxation should also be examined in light of the dearth of investment resources for the ports. Taxing port revenues would reduce their capacity to finance investments which are critically needed to maintain the ports competitiveness in a difficult environment. Tax payments would need to be compensated either by delaying investments (which could potentially have a very detrimental impact) or by further raising tariffs. In the medium-term, the economic (and social) costs of the resulting loss of competitiveness may well offset the fiscal benefits of a new tax.

79. If the Government decides to introduce a tax regardless, two principles should be considered:

- **Taxes should not be applied on turnover and revenues but on surplus** – and on the share of surplus that is available after provisioning for new investments. This should be accompanied by efforts aimed at optimizing the financial management of ports to ensure that surplus calculations are correct.

- **The level of taxation should be informed by an analysis of the price elasticity of traffic**, which would determine what the ports can bear: for example, a simple calculation suggests that in order to cover 75 percent of its investment needs over the next 15 years, and to pay Euro 43 million a year (LVL 30 million) in taxes, the port of Riga would need to increase its tariffs by 83 percent,48 which would obviously have a significant impact on the port’s competitiveness.

80. In short, two models can be considered – one with relatively low tariffs and no payment of dividends and/or taxes on surplus (depending on the ports’ legal status); the other with significantly higher tariffs with payment of taxes on surplus and dividends or equivalent contribution if the status of the port does not allow it. To decide between both, a detailed elasticity analysis is needed as the second option may involve a loss of competitiveness. Two other models, which are frequently being discussed, are simply not sustainable: the current model (with tariffs so low that they cannot cover investment needs) and a

47 http://www.baltic-course.com/eng/transport/?doc=83414
48 The assumptions include (i) investment needs of Euro 295 million (including Krievu Island project), (ii) revenues and costs used for calculations were based on 2011 accounts; (iii) growth of revenues at 5 percent a year, (iv) growth of costs at 4 percent a year, (v) discount factor of 10 percent, and (vi) Euro 43 million (LVL 30 million). If Krievu Island is excluded, tariffs would need to be increased by 56 percent to cover 75 percent of Riga’s investment needs over the period of the next 15 years (using the same assumptions (ii) through (vi).
model of (significant) taxation with no significant increase of tariffs which is not possible because the level of tariff is already too low to allow taxation without compromising investment.

**Recommendations**

81. *The Boards and management of the Ports should revise pricing policies in order to mobilize more revenues from their own sources.* In particular, the ports should: (i) shift the basis of fees from vessel size to actual cargo; (ii) increase the share of revenues from leases (as much as possible considering existing contractual arrangements); and (iii) increase tariffs to secure sufficient financing for critical investments.

82. *The Boards and management of the Ports should seek a reduction in the Ports’ operating costs,* through a combination of efficiency gains and tighter internal controls. Parallel effort should be made to control the costs of on-going and upcoming investments.

83. *The Boards and management of the Ports should adopt a clear investment appraisal method* – both economic and financial – based on international practices. The Ports should review current lists of investment plans in order to select and prioritize investments, promote low-cost solutions, and increase the predictability of capital and recurring costs. The ports should assess the extent to which tariffs can be increased (on the basis of a review of practices by competition and elasticity of the traffic). This would provide indications of the total financing that can be mobilized and hence of the investments that can be funded.

84. *The Government should base any decision regarding taxation on a detailed analysis of the price elasticity of traffic,* and the likely impact of a tariff increase on traffic. It is critical that decisions on taxation are made with due consideration to their likely impact on the ports’ competitiveness, in a difficult environment. Taxes, if any, should be applied on the ports’ surplus rather than turnover, and only after taking into account funding required for capital investment.

85. *The Government could consider letting the Ports establish a funding reserve mechanism which should not be subject to taxation by the Government.* The funding reserve amount could be calculated in order to help the ports borrow on their own balance sheets for their planned investments and secure these loans’ reimbursement. (This recommendation is especially valid if the recently established tax and the ports’ status are maintained).
4. Management Practices

86. Management practices are a key consideration for investors, operators, and port users to develop their business in a given location. In the Baltic region where the legal frameworks for port operations are by and large sound across all countries, competitiveness largely depends on the actual management practices (and the perceptions surrounding these practices). This is an issue of particular importance in the competitive environment which Latvian ports are facing, where traffic can easily be re-routed to other ports.

87. Several management practices in Latvian ports are generally in line with international practices. In particular, the Ports’ management has proven effective at managing their facilities and operations, at growing the traffic in a difficult competitive environment, at establishing working relationships with operators and service providers, at managing their obligations as a public authority (in terms of security, environment, etc.), and at generating an annual profit, even in the difficult years of economic crisis. These are no small achievements.

88. There are several areas where performance could be enhanced. This is also in line with global experience, where many ports still face a significant agenda of reforms. Key priority areas for Latvia are mainly those where international practices have significantly changed over the last period, either to allow for a better management (e.g., development of Key Performance Indicators), to remedy long lasting issues in the sector worldwide (e.g., transparency, conflict of interests, anti-corruption, and disclosure), or to complete the modernization and reform process (e.g., land allocation, free zone development, and towage services). The Latvian ports should aim to reflect and adopt the emerging good practices where appropriate, so as to remain at the forefront in the Baltic region.

4.1. Key Performance Indicators

89. Key Performance Indicators (KPIs) are a critical tool for port management, and for authorities to perform their oversight role. The government and municipalities fix objectives to ports as part of their overall strategy, which port management then needs to implement. The main tools used worldwide for the measurements of these objectives are KPIs. They are designed to measure the performance of a port relative to stated objectives, and hence to allow Boards and management to assess progress in improving performance, to monitor trends, as well as to identify issues and possible remedies. The selection of appropriate KPIs is critical as it will largely define the focus of efforts and attention. A simple and practical application of KPIs for Latvian ports based on available financial statements for the eastern Baltic ports is available in the recent KPMG publication.\(^{49}\)

90. KPIs currently used in Latvian Ports provide an incomplete picture of port competitiveness. These KPIs are primarily describing the gross level of port activity (e.g. total TEU or total tonnage). These are commonly reported indicators worldwide, especially for landlord ports (since they are not directly involved in cargo handling operations) and are frequently used to rank ports. However, traffic volumes often present a distorted picture: (i) they are not always accurate (e.g., transshipment ports double count containers, once when unloaded and then when reloaded; container volumes give equal weight to empty and loaded boxes; cargo tonnages often include container tare weight); (ii) they do not distinguish between low-value/high-volume bulk cargoes and high-value unitized cargoes; and (iii) they are affected by a number of exogenous factors which makes it difficult to establish solid correlations with a port’s competitiveness.

\(^{49}\) KPMG Baltics SIA. Competitive Position of Baltic States Ports, November 2013.
91. A number of performing landlord ports hence use a different set of KPIs. These KPIs measure market shares (relative to other ports serving the same hinterland), which provide a better measurement of competitiveness. These are complemented by financial ratios and capacity utilization figures. Additional indicators are used to measure the factors that contribute to port competitiveness, especially the quality of service: the quality of logistics services, as perceived by the users of the port, is an important factor in the competition for traffic. Quality of service is measured through various proxies such as: (i) the berth and gate turnaround times; (ii) cargo dwell times with and without clearance times; (iii) average port charges per unit of cargo; (iv) frequency of scheduled ocean and rail services; and (v) access to value added services. These proxies can be further complemented by more detailed and differentiated indicators (as detailed in Table 15).

- **Cargo Services.** KPIs as detailed in Table 15 aim to assess utilization of port assets and those of individual terminals. They include: (i) berth occupancy; (ii) annual cargo throughput per unit of leased area; (iii) waiting time and turnaround time (on a terminal-by-terminal basis). These measures are additional to those used by terminal operators to monitor the operational efficiency of facilities and equipment and the quality of specific services provided to the vessels and the cargo. These KPIs are best assessed by looking at trends rather than absolute values as there are a number of factors affecting performance (e.g. macroeconomic factors affecting trade, pricing policies applied by neighboring countries, investments in new infrastructure and cargo handling technology as well as basic factors such as location and waterside access).

- **Supply Chain.** The supply chain approach considers connectivity for both land and water transports and also the transit time and reliability for movements along specific trade corridors. Although the performance of supply chains has a profound impact on a port’s competitiveness, measures of this performance lack simplicity and consistency. Equally important, the port has limited influence over the performance of these supply chains. Despite these limitations, measures of supply chain performance for the port’s primary trade corridors have two important applications. First, they can be used to identify the end destinations/production areas where the port should promote its services to large volume shippers, e.g. producers/consumers of bulk cargoes. Second, they can be used to encourage joint action by logistics services providers to improve overall supply chain performance and thereby attract more shippers. The supply chain KPIs detailed in Table 15 should be reported for each major cargo type (liquid bulk, dry bulk, containers, RoRo, break bulk). These KPIs focus on the interface between the port and both shipping and land transport.

- **Cruise Line and Passenger Ferry Services.** The ports should also adopt a number of KPIs for cruise line and passenger ferry services which represent additional business for the port. The international experience shows that the use of these KPIs usually applies to home ports where these are the primary activity (e.g., Everglades, Piraeus, San Juan, Singapore, Southampton). For multipurpose ports, cruise and passenger ferry traffic is a small component to the port business, but can be an important contributor to local economic activity. Therefore, the KPIs shown in Table 15 focus on measures used to quantify this contribution. In case of Riga, these can represent a substantial source of revenue.

- **Free zones.** The Ports have designated areas for the establishment of industrial and commercial activities that can benefit from the linkage to the port. In Ventspils, there is direct linkage to the port, the sites are already partially developed and some enterprises are already located in the area. Riga on the other hand has limited areas for further development and many areas are in the city. The objectives of the free zones are the generation of employment and economic activity for the...
surrounding communities. Two types of KPIs are usually applied to Free zones (Table 15). One measures the success in developing these zones and another one measures the benefits derived. The data for these KPIs is part of the normal set of information collected by the parties responsible for the development and management of the zone. In the case of Ventspils, this data is already collected. Since good management practices are to develop a zone in phases with sub-areas developed and leased out in sequence, the KPIs related to the development can be calculated for both the entire zone and for the subareas that have already been developed. In the case of Riga, which may wish to redevelop part of its land for urban purposes as part of its development rather than as industrial/free zone type of areas, adjustment to these KPI can be made to reflect this objective.

Table 15. Proposed Key Performance Indicators

<table>
<thead>
<tr>
<th>KPIs</th>
<th>Objectives</th>
<th>Data source</th>
<th>Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Port Performance Indicators</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>National and regional market shares by cargo</td>
<td>Competitive Position</td>
<td>Regional port statistics</td>
<td></td>
</tr>
<tr>
<td>Tonnage by cargo type</td>
<td>Diversification</td>
<td>Port statistics</td>
<td></td>
</tr>
<tr>
<td>No. of firms involved in activities other than cargo handling and essential vessel services</td>
<td>Value-Added Services</td>
<td>Port and local statistics</td>
<td>Trends</td>
</tr>
<tr>
<td>Turnover of these firms</td>
<td>Value-Added Services / Diversification</td>
<td></td>
<td></td>
</tr>
<tr>
<td>No. of jobs created near the port (in logistics clusters)</td>
<td>Value-Added Services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income (salaries) distributed by these firms</td>
<td>Value-Added Services</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Port Performance Measures</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land Utilization</td>
<td>Productivity of port land</td>
<td>Port statistics</td>
<td>Trends</td>
</tr>
<tr>
<td>Outstanding Lease Period</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating²</td>
<td>Financial Sustainability</td>
<td>Port Annual Report</td>
<td>Benchmarks and Trends</td>
</tr>
<tr>
<td>Current²</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net margins³</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>by Terminal</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Berth occupancy</td>
<td>Capacity, Utilization</td>
<td>Terminal statistics</td>
<td>Benchmarks and Trends</td>
</tr>
<tr>
<td>Average vessel turnaround</td>
<td>Quality of service</td>
<td>Harbormaster</td>
<td></td>
</tr>
<tr>
<td>Average vessel waiting time</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average tons or TEU per vessel</td>
<td>Terminal statistics</td>
<td></td>
<td>Trends</td>
</tr>
<tr>
<td>Revenues per Terminal versus investment¹</td>
<td>Financial Sustainability</td>
<td>Port financial records</td>
<td></td>
</tr>
<tr>
<td><strong>For bulk terminals</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tons per berth or meter quay</td>
<td>Productivity of port land</td>
<td>Terminal statistics</td>
<td>Benchmarks and Trends</td>
</tr>
<tr>
<td>Average wagon turnaround</td>
<td>Quality of service</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>For container terminals</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Box volume per berth</td>
<td>Productivity of port land</td>
<td>Terminal statistics</td>
<td></td>
</tr>
<tr>
<td>TEU per vessel per hour per berth</td>
<td>Quality of service</td>
<td>Terminal statistics / Shipping lines</td>
<td>Benchmarks and Trends</td>
</tr>
<tr>
<td>Average berth occupancy</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turnaround of trucks</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Supply Chain Performance by cargo type</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vessel Calls by cargo type</td>
<td>Competitive Position</td>
<td>Port statistics</td>
<td>Trends</td>
</tr>
<tr>
<td>Average vessel size by trade</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Container Shipping Services, No. and Frequency of calls</td>
<td>Shipping lines</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Modal split for inland transport</td>
<td>Supply Chain Performance</td>
<td>Port and Railway statistics</td>
<td>Benchmarks and Trends</td>
</tr>
<tr>
<td>Average rail travel time border to port station</td>
<td></td>
<td></td>
<td>Trend</td>
</tr>
<tr>
<td>Average rail transit time station to terminal</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

⁵¹ Value-added services typically lead to generation of more skilled jobs. This indicator will allow to monitor if this has been achieved.
4.2. Transparency

92. **The Ports’ KPIs should be reflected in contracts with operators.** In a landlord port, management has limited direct influence on the port’s competitiveness, which in large part depends on the private operators. Contractual arrangements, e.g., concessions, operating leases and land leases, provide the vehicle to ensure that the Ports’ KPIs can “cascade down”, and be translated into specific obligations for private sector operators. This allows Ports’ management to assess and monitor performance relative to specific targets, and to take action if and as needed.

93. **There have been persistent allegations that management practices in Latvian ports are not transparent.** Such allegations are common across the world – and the World Bank has neither a mandate nor the capacity to verify their accuracy. There is ample international evidence that regardless of their veracity such allegations are very damaging to the ports’ image, to their attractiveness for new operators, and to their overall performance and competitiveness. Specifically, allegations in Latvia cover three areas: (i) the prevention of conflicts of interests; (ii) mismanagement and corruption in the use of public resources; and (iii) disclosure of information.

94. **The Latvian Parliament adopted a Law on the Prevention of Conflicts of Interest in Activities of Public Officials in 2002.** The purpose of the Law is to ensure that the actions of public officials are in the public interest, and to prevent the influence of a personal or financial interest upon the actions of the public official. It requires public officials to make a declaration of interests (which are independently verified), and to desist from the making of decisions in matters in which they (or their close relatives) are financially or otherwise personally interested. This law provides a sound legal framework to prevent conflict of interests and is in line with international good practices (see key provisions in Box 7).

95. **However, this Law is not accompanied by implementation arrangements in the Ports’ regulations, and the legal framework may not capture all possible cases while at the same time such issues have been sometimes debated without any decisive issue.** The current situation puts Latvian Ports in a weak position as there have been persistent allegations that specific Board members may have interests in operators of some terminals or in companies which are controlling large areas of the ports. This has created doubts on the transparency in the decision-making process and is undermining the ports efforts to attract new operators. There may be gaps in the applicable framework as otherwise past allegations should have been decisively dissipated from a legal standpoint. Subject to a legal review which could be carried out by the government, experience in other ports suggests that the effective enforcement of the Law on Conflicts of Interest and tackling it openly and transparently in the Port bylaws would go a long way towards addressing these perception issues (see Box 7).
The conflict of interest provision in regulations does not prevent individuals with multiple interests from serving on a board or in administration; it prescribes behavior that would be expected from individuals involved in governance in circumstances when a conflict of interest arises. It is a common practice to see this provision in board charters or regulations of port boards worldwide. It clarifies the responsibilities of the full board, individual board members, executives/administration staff and employees of the organizations in various circumstances when a conflict of interest arises.

The Board Charter of the Sydney Ports Corporation requires board (or committee) members to disclose potential conflicts in the port’s conflicts register which is regularly updated. The port’s audit and risk committee charter also states that “a Committee member cannot take part in discussions or vote on a matter in which that Committee member has a material personal interest; unless the Committee resolves that the interest does not disqualify the Committee member.” Furthermore they should not (i) have served in a management position in the ports for at least three years; (ii) be a material (i.e. with more than 5 percent of the SPC’s gross revenues) supplier or customer of the port; or (iii) have a material contractual relationship with the business other than as a Director of the business.

The Port of Rotterdam requires that a Board member cannot have been employed by the port in the last five years; or have an important business relationship with the port authority; or have a shareholding of over 10 percent in the company; or have a shareholding of over 5 percent in a company established in the port.

The UK’s guidance on port trusts states that board members have a duty to declare any private interests which might influence their trust port duties, and to take steps to resolve any conflict arising.51

96. Allegations have also been made, most recently by the well-respected State Audit Office (SAO), with regard to several systemic weaknesses of the Ports’ management systems. Given its limited human and financial resources, the SAO does not have the capacity to undertake detailed audits of each public agency every year. In the recent audit of the Freeport of Riga for 2012, the SAO raised allegations with regard to fraud and misuse of funds, inefficient use of funds, misuse of land, inappropriate accounting practices and expenditure classification, selective revenue collection, wrong tendering, wrong tariff classification and other issues.52 Similar issues were raised in the audit report of port of Ventspils for 2011 by the SAO. It is worth noting that the amounts mentioned in the SAO’s Audit do not look insignificant when compared to the Port of Riga’s profits of LVL 11 million.

97. Finally, performing ports worldwide tend to apply a proactive approach to information disclosure. They typically provide a summary of and link to the full text of their national law on freedom to information (or access to information). In addition, these ports have a respective provision in their Bylaws/Regulations which explains in greater details what information is considered confidential and what information the ports are committed to disclose to the general public. By contrast, Latvian ports’ Boards allow only limited participation of the public and of private sector representatives in their meetings. Recently, the Ports have started to publish key decisions made by the Board – a welcome

initiative which should be sustained – but disclosure of financial information, lease contracts, etc. remains limited. Other ports use disclosure of information to attract operators and investors and market their competitiveness. For example disclosure of commercial information can give confidence to investors that everybody will be treated on an equal footing, and disclosure of investment plans (which competitors can usually find out anyway) can show to interested operators or investors what development the Ports are considering and can increase their interest. Finally, disclosure of information that is typically under public scrutiny (procurement, main contracts) is an easy way to prevent rumors around these operations.

Box 8. Information Disclosure in Other Ports

| Port Authorities of New York and New Jersey, Los Angeles, Seattle, regularly disclose (i) description of governance structure and all legal documents regulating the governance structure of the port; (ii) financial information, including budget and capital plan, proposed annual operation budget, consolidated bonds and notes, financial statements and annual reports; (iii) information related to the work of the board, including agendas, minutes and videos of regular board meetings, special meetings or committee meetings, and an archive of those materials; (iv) port leases (e.g., from 1976), and business transactions, including claims log, awards of contracts, award of leases and permits, insurance transactions.53 |

4.3. Land allocation

98. Land is a scarce and valuable public asset for ports. Its allocation to specific operators is a strategic choice that has typically a major impact on the port’s medium-term development prospects. It is also a potential source of important revenues for the port authority. On the downside, the allocation process can also be an important source of corruption, in view of the financial interests at stake. Performing landlord ports hence aim to establish a system for land allocation which ensures strategic alignment with the ports’ overall objectives, maximizes the use of the available land, is transparent, and allows for the periodic entry of newcomers.

99. Current practices in Latvia diverge from good international practices in several ways:

- Optimal use of land. Serviceable land is available in both ports for further development. In most landlord ports, areas for development are typically selected on the basis of the suitability of their physical characteristics to the cargo’s requirements, e.g., (i) waterside and landside access, (ii) the proportion of wharf and backup areas, (iii) minimum scale required to attract cargo, and (iv) environmental impacts on adjoining sites. The current Riga Spatial Plan for Mangalju Pussala, Krievu Sala, Spilve and Kundzipsala (to relocate terminals from the city centers) and the proposal for the North Terminal (to expand the port land) in Ventspils are intended for this purpose, but they do not appear to meet these criteria. For example, Krievu Sala has been designated for relocation of the urban terminals that include dry bulk, RoRo and general cargo while Kundzinsala is planned to have both chemical and container terminals (while normally chemicals are isolated from the rest, especially high value goods). Terminals (e.g., warehouses) which do not provide services requiring waterside access should be proposed for other uses.

• **Strategic alignment.** For a landlord port, the lease agreement is an important instrument to ensure the operator’s effective contribution to the port’s competitiveness. Performing ports tend to include in the lease agreements a clear definition of the expected activities for the operators, required performance standards aligned with the port’s own KPIs (possibly minimum guaranteed traffic levels with penalties if they are not achieved), payments due, obligations to invest, and environment obligations. In Latvia, these contracts are not public and the World Bank had access to a very limited sample without knowledge of whether it is representative or not. However, the applicable Ports’ regulations do not require the inclusions of such provisions in the lease agreements, and reportedly, a number of lease agreements may lack some of these important parameters. Modern leases would allow the Latvian port authorities to monitor efficiency and competitiveness of the operators and would set clear conditions for termination of the leases in case of poor or inadequate performance by operators.

• **Transparency.** Performing landlord ports tend to rely on competitive processes to allocate land. Such processes have a clear statement of objectives (aimed at ensuring the outcome of the process is aligned with the ports’ strategic objectives), and high standards of transparency. For facilities which typically can attract several operators and serve the whole economy (e.g., common user terminals) leases are granted through a public or competitive process, a formal evaluation of solicited proposals (e.g., based on maximum rent or minimum user charge) on the basis of explicit selection criteria (related to the quality of service and potential for attracting traffic as well as the financial terms offered). For the development of dedicated terminals, i.e., terminals that handle their own products (e.g., an oil trader or coal trader), the process is based on a review of unsolicited proposals and often rests on mechanisms such as the Swiss challenge to ensure a degree of transparency and competition. Such processes and their outcomes should be made public. According to ESPO’s European Port Governance 2010 survey, three quarters of the surveyed ports in Europe apply, always or conditionally, public selection procedures to contract out port land. Those port authorities that always or sometimes use a public selection procedure use public tender (64 percent), competitive bidding (21 percent) or other types of procedures (around 15 percent). In Latvia, the initiative for new developments of all types of terminals (whether common facilities or dedicated terminals) often comes from unsolicited proposals from operators or major port clients. Land leases are generally granted on a “first-come, first-served” basis, without a competitive process, after a closed-door discussion of the Board. Lease fees are negotiable and approved by the Boards, but not made public.

The nature of business in Latvian Ports can partly explain this process (apparent excess land in Ventspils, need to lock long term commitments of some of the main clients which can guarantee significant volumes, especially in both ports’ main commodities). However, such transactions can still be carried out in a much more open manner without compromising the attractiveness of the Port for investors, while providing additional guarantees to the Port Authority as to the good use of the land and of the conditions of the deals.

---

54 The leases for dedicated terminals (e.g., oil or coal terminals) may lack conditions outlining the activities that can take place, the types of cargo that can be handled, a minimum level of activity required to maintain the lease and environmental constraints on the use of the land. The land leases for common user terminals (e.g., container terminal) may lack these conditions as well as provisions to ensure common access, non-discriminatory pricing of services and performance requirements (KPIs) to ensure a minimum quality of service for all users.

55 A public tender involves a call for proposals whereby all relevant contractual details are specified in advance, while a competitive bidding involves an open call but with contract details negotiated in a later stage.

56 There will always be only one candidate to be the operator, and the performance of this operator has little impact on the whole economy, only on its own business.

57 A Swiss challenge is a form of public procurement which requires a public authority that has received an unsolicited bid for a public project (such as a port, road or railway) or services to be provided to government, to publish the bid and invite third parties to match or exceed it.
• **Potential entry of newcomers.** The potential for newcomers to enter is largely determined by the duration of standard leases. Contractual arrangements should “strike a balance between a reasonable payback period for the investments made by the terminal operations, on the one hand, and a maximum entry to potential newcomers, on the other” (ESPO). Across the European Union, there are significant variations in the duration of standard leases, with a good practice of about 30 years. However, in Latvia, most leases are for 45 years with an automatic renewal. This does not appear to be justified by the corresponding capital investments (which tend to be relatively limited). It significantly hampers the Ports’ ability to replace non-performing operators as well as to modify land use periodically so as to adjust to rapidly changing markets.

4.4. Free zone development and towing services

100. **The Latvian Port authorities have responsibility for the development of both the port and the adjoining industrial sites** (and free zones). The development of industrial areas complements ports’ contributions to the national economy and contributes to attract high-value-added activities in the port areas. International trends shows that more privately run special economic zones have mostly been established under private management in the past few years (cf. Box 9). These new arrangements are seen as more effective to boost value added and revenues, and to promote economic diversification and generate more employment. International experience suggests that fiscal and financial incentives play a relatively minor role in the medium-term success of such zones – which depends a lot as well on the business climate, including infrastructure, human capital, regulatory environment, the rule of law, and good governance. The European Commission usually has a restrictive policy on free zones by international standards, as it promotes above all a common market (cf. Box 9) and as such does not encourage “tax competition” between countries.

101. **Further development of the free zones in Riga and Ventspils is very challenging as none has a decisive advantage over regional competitors.** The situation of firms operating in the free zones has led the government to extend the benefits of the regime to 2035 instead of 2017 due to depressed economic activities during and after the crisis. Although Riga handles containers, which present a higher potential for developing additional activities in an adjacent free zone, it lacks additional land to expand the free zone and already suffers from road/rail access congestion. Ventspils has more space in the city than Riga and could offer advanced infrastructure, but handles few of the type of cargo that attract transformation/packaging and logistics industries (only general cargo and some RoRo containers, but no traditional container traffic). Liepaja has been developed from the start as a free zone with a much larger land available, and has managed a development based on the products in which it had comparative advantages due to industries (metal) and agricultural products.

**Box 9. Management of Free Economic Zones**


Perhaps the most notable trend over the past 15 years has been the growing number of privately owned,
developed, and operated Special Economic Zones (SEZ) worldwide. 62 percent of the 2,301 zones in developing and transition countries are private sector developed and operated. This contrasts greatly with the 1980s, when less than 25 percent of zones worldwide were in private hands. The key factor behind the rise of private zones is the perception that private zones are more successful than most public zones, as well as a general lack of funding for governmental zone development.

Available data suggests that private zones are less expensive to develop and operate than their public counterparts (from the perspective of the host country), and yield better economic results. Public expenditure cost savings through private zone development depends significantly on where private zones are located and whether they are subject to any designation criteria and development controls. Most modern programs to develop free zones include appropriate location and development criteria. In this context, privately operated zones tend to offer better facilities and amenities, command higher prices from tenants and attract “higher end” types of activities. As a result, private zones generally have been more profitable and have had better social and environmental track records than public zones throughout the world (with East Asian government-run zones the notable exception).

Another significant recent trend has been the evolution of the types of bodies developing, administering, planning, and promoting zones on the one hand, and regulating zone activity on the other. A variety of institutional frameworks has been used for SEZ regulation, development, and management. These include autonomous government authorities or corporations, specialized departments within a ministry, zone-specific management boards, and rarely, arms of investment promotion agencies. With private sector entering zone development, most countries have either set-up specialized public sector zone development and management agencies, or increasingly divested the physical project development function to the private sector, and transformed their zone authorities into purely regulatory, planning, and promotional bodies.

International experience suggests that the recommended approach is to adopt a SEZ model with the following features:

- Permit industrial estates to host SEZ enterprises as well as those licensed under other regimes. The preferred approach is to allow all enterprises to co-locate within the same area, although the development of separately fenced-off areas solely for zone enterprises (as in Philippine and Thai zones) is also an acceptable approach;
- Ensure that the SEZ regime is flexible, allowing a range of commercial as well as manufacturing activities. If properly supervised, a separate commercial zone regime, as in Malaysia and Thailand, is not required;
- Promote private rather than public development of zones. International experience suggests that private rather than public development of zones increases the chances of success. Outside East Asia and Dubai (United Arab Emirates), the vast majority of government-developed and -run zones have been consistently less effective than their private counterparts.

The EU Customs Code (last version adopted on October 9, 2013) considers free zones as one of the possible procedures to import goods into the union and provide for facilities that allow transformation and re-exportation, and authorizes governments to provide additional fiscal or non-fiscal benefits to free zone companies provided that they do not distort domestic and Union competition. It also requires a fenced-off location. The European Commission is currently undertaking a review of free zones.

Free zones are therefore permitted as one of the tools for business development in the Union but are not very strongly encouraged, as the Commission is favoring a policy of homogeneous and business friendly regulations within a country rather than in specific areas. This is consistent with the conclusions of

---

worldwide trends, which indicates that benefits of free zones lie first of all in the infrastructure facilities that are provided (including link to the port areas) and the other facilitating services that allow easy operations both in terms of administrative processes and access to markets.\footnote{The position of the European Commission is that Special Economic Zones can be established on the territory of Member States and undertakings located therein can receive support, e.g. for new investment, as long as it is granted according to EU rules, including state aid rules. In any case, the implementation of free zones requires significant administrative capabilities within host governments to ensure adequate regulation and facilitation. In particular, the development of an appropriate legal, regulatory, and institutional framework is needed, including an efficient tax administration and labor inspectorate office. At the same time, the risks of tax evasion and transfer pricing that would jeopardize budgetary revenue targets must be minimized. The European Commission promotes horizontal measures aiming at improving the business environment across economic sectors and regions in Member States.}

102. \textit{Finally, the Port of Riga is using a mix of private and port authority towage services} (in Ventspils, services, including towage, to the vessels that use the port and services to the cargo are fully outsourced to the private sector). There are very few ports where towage services are provided by port authorities, and those are typically smaller ports in developing countries where shipping traffic is limited. In larger ports most towage services are run by competing private companies, licensed by the port authorities. The current arrangements in Riga are raising both issues of cost effectiveness and potential conflicts of interests as the port authority is both service provider and authorizing authority for private operators.

\section*{Recommendations}

\subsection*{Key Performance Indicators}

103. \textit{Boards should require Ports management to adjust the KPIs which are used to assess the Ports’ performance.} In particular, management should collect and provide the Board with data that would allow to measure progress with regard to the Ports’ competitiveness. Such KPIs should include the Ports’ market shares (relative to other ports serving the same hinterland, including the Russian ports of Primorsk, St. Petersburg and Ust-Luga, and with a breakdown by form of cargo and key commodity), quality of service indicators, as well as specific indicators per Table 15.

104. \textit{Boards should set quantitative and qualitative targets} which can be assessed through the use of KPIs, as part of the annual planning and budgeting process. This should include financial ratios and capacity utilization figures, as well as market shares, quality of services, and other specific indicators. It would allow to measure the Ports performance against pre-agreed objectives.

105. \textit{Ports management should ensure that relevant contracts with operators reflect the agreed KPIs and targets}. Since the ports have a responsibility for ensuring the quality of port services, even though they do not provide these services, monitoring and evaluation of KPIs should be part of the quality assurance process. One of the KPIs that should be included in the lease agreement with container terminals is TEU per vessel per hour per berth, with a minimum target of 40 TEU. A well performing container terminal usually handles around 60 TEU per vessel per hour per berth. In the case of other types of cargo (especially bulk and dedicated terminal) as productivity targets depend on the sales contract between the shipper and the operator there is no rationale to introduce KPIs in the lease contract.

\section*{Transparency}

106. \textit{The Government of Latvia should consider carrying out an independent third-party legal review of the implementation of the Law on Prevention of Conflict of Interests by Latvian ports and on handling of conflicts of interests in the Ports}. The objectives of this third-party legal review should be two-fold: (i) to identify any gaps in the way conflicts of interests are handled in the ports taking into
account the Law on Conflict of Interest of 2002 and other legal texts applicable to the ports, and (ii) identify needs (if at all) for amendment of the Ports’ regulations to ensure compliance of the ports with the Law on Prevention of Conflict of Interests. The review should also determine if there are any gaps in the existing relevant regulation, i.e., the concerned National Law and Ports’ Regulations, for example with regards to (i) requirements for Board members and members of ports’ management to participate in decision-making process if a conflict of interest arises in relation to a specific transaction; (ii) thresholds for shares in other companies to be allowed for Board members and members of port management to participate in decision-making process about related to transactions with those companies; and (iii) clear reporting line for declaration of conflict of interests for Chairmen of Boards, Board members, and members of ports management.

107. As part of this effort to demonstrate port authorities’ commitment to transparency, the websites of the ports should either publish a list of persons who are included in the National Register of Interests or provide a link to the National Register of Interests that will automatically generate the list of persons (incumbent and new members of Boards or managements) or companies associated with the concerned port. The lists on the ports’ website should be updated regularly based on the information provided in the National Register. In addition, such information from the National Register should be included or referred to in each Annual Report which will be consistent with international good practices.

108. Ports management should continuously review and enhance internal control systems, to prevent both corruption and allegations of corruption. Areas which typically require particular attention include: procurement systems (rules, compliance, and actual practices), which should be based on open competition and transparent contract award processes; financial management systems (rules, compliance, and actual practices), which should reflect the best professional standards; and key decisions affecting private operators (e.g., allocation of land, contracts with operators, etc.), which should follow transparent processes. Ports management should also establish the practice of carrying out internal audits (in addition to external audits) on a regular basis, and reporting the main findings and recommendations to the Boards. The internal audit function, if established, should directly report to the board and not to the management (see the next Chapter).

109. The Board of Riga Port should publish a full response to the findings of the recent SAO audit. Such a response should include a clarification or correction of some of the findings (those findings which may be inaccurate or misinterpreted), as well as a time-bound action plans to correct observed deficiencies. The publication of such a response is important to dispel perceptions within parts of the public and the business community that management practices in the port are inadequate.

110. The Boards should amend the ports regulations to strengthen disclosure requirements. In line with international best practices, Ports managements should disclose on their websites a significantly increased amount of information. The disclosure policy should be based on the guiding principle that all information is to be made public, unless the Port Authorities can demonstrate that information falls under the following category:

(i) Personal information (except what is required by law from executives in terms of revenue disclosure or conflict of interest);
(ii) Internal communication between the Port Authority staff and/or board members;
(iii) Information that would compromise security and safety of the Port Authority, port customers and the country; and
(iv) Deliberative information (information related to on-going internal discussion on issues and decision has not been reached yet).

111. Examples of documents which are not considered sensitive by other ports and are disclosed on their websites include (the list is exhaustive):
Port Authority’s Information Disclosure Policy which defines the Port Authority’s compliance with the National law on information disclosure (or equivalent to it), guiding principles outlining types of information to be disclosed or not disclosed, procedures for public access to information or request for information (fees, application process, feedback, etc.);

Legislation and policy documents relevant to the PA;

Governance structure, profile of Board members and key management members, agenda of Board meetings, minutes or decision points of Board meetings;

Annual reports with analysis of financial and operational performance;

Progress reports on implementation of policies/development plans;

External Financial and Operational Audit Reports and statements of Boards in response to Audit Reports;

Procurement processes (calls for expression of interests with objectives, clear requirements for candidates, brief description of terms, etc.);

Lease agreements with or without commercially sensitive information (cf. examples from the Port Authority of New York New Jersey – some ports do have a policy of full disclosure);

Monitoring of KPIs, etc.

Land allocation

112. The Boards should amend relevant ports regulations to improve the processes for allocating land, in line with international practices. This would include: (i) requiring management to introduce performance standards (based on the Ports KPIs) in new lease contracts for common user terminals, including possible penalties if they are not achieved; (ii) making as much as possible mandatory the use of competitive processes (i.e., use of a public or competitive process for common user terminals or use of Swiss challenge for dedicated terminals when a proposal is made without solicitation by operators) to allocate land (through evaluation of solicited proposals based on maximum rent or minimum user charge), in line with international practices, as well as the disclosure of (non-commercially sensitive) elements of the bidding process (including at least the criteria for selection or rejection of proposals); and (iii) instructing management to reduce the standard duration of a lease to 30 years.

113. Ports management should aim to renegotiate key elements of existing lease agreements whenever the opportunity arises. As port authorities have been in place since 1994 and the key operations have been leased for very long period, new leases and land allocation criteria will only impact a fraction of port operations. When possible, points for renegotiation should include: (i) the introduction of performance standards (and corresponding penalties); and (ii) the duration of leases (where it exceeds 30 years). This should be done in a pragmatic manner, using opportunities that may arise to amend the lease agreements and assessing the land that has stayed unutilized for a long time. Management would need to strike a balance between asking for too much (and losing leverage on other issues which may be up for renegotiations) and asking for not enough (and missing the opportunity to improve contractual arrangements). The Boards should require management to report on these renegotiations in detail to ensure adequate supervision and accountability.

Free zone development and towage services

114. The Government of Latvia may want to consider two options for management of free economic zones in ports: (i) creation of an autonomous unit within the port authority or (ii) creation of a separate authority with a private sector-run management. 63 Although there are strong synergies between free zones

63 Guidelines for the institutional arrangements of economic zones can be found in OECD’s “Towards Best Practice Guidelines for the Development of Economic Zones” at http://www.oecd.org/mena/investment/44866585.pdf
and ports, there are some differences in terms of infrastructure and operations. Both ports and free zones require capital investments to upgrade sites and marketing actions (which can be joint) to attract private sector enterprises, but the type of land and nature of companies using port areas and free zones are often completely different (manufacturing, packaging, assembling in free zones, terminal operators in ports, while logistics operators can be present in both). Therefore, management of a free zone requires a different set of skills and experience from the one needed to manage port activities. Being at least autonomous within the port authority (first option) will ensure focused management of the free zone. Private sector-run management of free zones (second option) is widely considered as a superior strategy to align incentives. If the second option is eventually considered, the separation should be managed in such a manner as to retain a strong collaboration between these new authorities and the Ports Authorities in order to ensure a seamless movement between the port and the industrial area, which includes both transport services and customs clearance procedures. The management of the industrial zones should develop a proposition for the sites, plan the phased development of the areas, identify the target markets and seek out anchor tenants to promote the development of the site.

115. The government should explore several options to further develop its free zones in the ports of Ventspils and Riga. Ventspils’s cargo is not conducive to free zone development, although the city of Ventspils has more space, while Riga is closer to a larger market but lacks space in the city and access. Overall, three alternatives can be considered: (i) no change to the free zone space in the Ports of Riga and Ventspils, (ii) expansion of the free zone (which will be designated for activities not requiring waterside access) in the port of Riga to the suburbs of Riga, or (ii) merger of the Riga and Ventspils free zones in order to benefit from the available land in Ventspils. The latter option would require establishing a specific management body (e.g., a free zone authority managing both free zones) and could benefit from logistics services from both ports and propose areas in one location or another depending on the needs. Either of these two latter options would add more flexibility to and increase the attractiveness of the Ports for logistics or industrial operators. Although 200 km between Riga and Ventspils is a significant distance, it can be manageable for some business if other logistics providers (e.g., railways) are efficient in the provision of their services. Liepaja could be considered as well but is more distant from Riga.

116. The Riga Port should develop a plan for divestiture of the residual port services including towage. This plan should ensure that service can continue to be provided in good conditions, and that the divestiture is carried out through a transparent process.
5. Governance and accountability

117. *International experience abundantly demonstrates that accountability is key to performance.* This is true for both the public and private sectors, for individuals as well as at for institutions. For Latvian ports, which are operating in a very difficult competitive environment, performance by all institutional stakeholders – and especially by Boards and management – is critical. Accountability mechanisms make it possible to evaluate such performance on a regular basis and to act on the findings of the evaluation to correct observed deficiencies.

118. *Accountability* is also an essential element for the management of public assets and public resources. It is a protection against the risks of corruption and it provides the general public with confidence that resources will be used effectively. This is especially important for public entities which are managing large amounts of funds. A number of rules and recommendations have been developed, for example by the OECD, to translate general principles into actual and practical recommendations for public entities. These were essentially designed for public entities that are “corporatized” and that are either subject to the company law or specific laws applicable to public enterprises. Many of these OECD Corporate Governance Principles can however be applied mutatis mutandis to administrative bodies such as Latvian Port Authorities. However, the usual practice for entities with status similar to Latvian Port Authority does not always correspond to the logic of OECD rules, which may make them difficult to apply, for example in the functioning and roles of Boards. A switch of the governance structure of the ports to a system close to the laws applicable to public corporations may facilitate the implementation of OECD rules in the sector.

119. *The challenge is to build systems that will provide for effective accountability.* Individual or institutional performance may be strong and financial practices may be sound, even in the absence of a clear accountability framework. Informal evaluation and feedback may provide for an appropriate degree of control and oversight. However, effective accountability requires the setting up of mechanisms that can ensure that performance is systemically managed, and not only the results of a combination of ad hoc factors.

120. *In the case of Latvian ports, accountability systems need to encompass several features:* the legal framework, the oversight function by the public authorities, the functioning of the Boards, the relationship between Boards and management, and finally the existence and full disclosure of independent external audits. Transparency in decisions is also critical to foster the accountability of the system to the general public.

5.1. Legal framework

121. *By the Law on Ports (1994), Latvian ports are “derived public persons” which imply certain limitations not only in their operations but also in governance and accountability systems.* Under public law, the objective function of Board members and management of Latvian ports is to minimize the risk of deviation from the letter of law, with the constraint of not generating losses to the government. In a corporate structure the incentives are different – the objective function is to maximize the long term value

---

64 According to OECD, “being accountable is, by definition, being liable to be called to account, answerable. Accountability is ensured by structures and procedures that oversee and control the actions of economic and political powers.” For state-owned enterprises, the accountability chain is complex as it involves management, board, auditors, the ownership entities, the government, the Parliament and in fine the general public. http://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/40096845.pdf

for shareholders within the constraints of the law (in the case of a public enterprise this value can have a monetary of non-monetary sense).

122. **The Latvian Law on Ports is complemented by additional laws and regulations.** The Law on Ports regulates the principles of port activities and the port’s administrative procedures. Separate laws for each port regulate procedures and conditions for granting the status of a licensed capital company within the port territory. Complementary Cabinet Regulations (bylaws) spell out the responsibilities of the Port Authorities and of their Boards, and regulate the appointment and removal of Board members, their remuneration, and the duties of the Chief Executive Officer (CEO). In turn, each port has issued its own regulations on issues such as the structure of the Port Authority, the rights and obligations of the harbor master, the behavior of vessels in the ports, the use of port areas, the dues and charges, etc.

123. **The Port Authorities are governed by both public and private law, depending on the nature of specific responsibilities.** As regulators, the Port Authorities are responsible for applying conventions, laws, and regulations, (e.g., on public safety and security, environment, navigation, and health, or to collect taxes and fees). Under Private Law, they manage public infrastructure and public space, and provide security for the facilities. The private sector provides port operations and services and finances superstructure.

124. **Port Authorities are comprised of the Board and the Executive Body (or Administration).** The Board is the highest decision-making body and is appointed for half by the government and for half by relevant municipalities. The Executive is subordinated to the Board and executes its decisions. It is headed by a CEO who is appointed by the Board.

125. **Compared to practices in other ports, the Latvian ports’ regulations provide little detail on some key internal processes.** The 1994 Law provides a framework which is overall consistent with international good practices. The Laws governing each port are also sound. However, such legal instruments are most effective when they are complemented by detailed regulations, which spell out specifics for their implementation. In this context, the Latvian ports’ regulations are less developed than in most well-performing ports. For instance, these regulations do not cover important areas such as: (i) the establishment of Board committees; (ii) the profile, expertise, and independence of Board members; (iii) the election, terms of office, duties and responsibilities of the Chairperson and Deputy Chairperson of the Board; (iv) the conduct of Board members during and outside Board meetings; (v) conflicts of interest, etc. In many countries, it is each port’s internal regulations, not the Law, that typically regulate those issues and provide more specifics on enforcement of the relevant provisions in the regulations (bylaws).

126. **The Latvian Ports could communicate better on several standard governance measures required by law.** This is the case of most measures related to conflicts of interest (based on the 2002 law on “Prevention of Conflicts of Interest in Activities of Public Officials”) and transparency. As there have been many perception issues related to both subjects in the last years, Ports should be forthcoming in addressing them upfront. Improvements were recently observed in this regard on disclosure of board decisions.

---

66 The Latvian Law on Ports stipulates that “Restrictions related to entrepreneurial activity, obtaining of income, combining offices and performance of work by the Chairman of the Board and the Board members as well as other relevant restrictions and obligations shall be subject to the provisions of the “Law on Prevention of Conflict of Interest in Activities of Public Officials.”
5.2. Oversight – The role of State, Municipalities and the Port, Transit and Logistics Council

127. **By law, Port Authorities as "derived public persons" are placed under the oversight of the Cabinet of Ministers.** The 1994 Law on Ports established the Latvian Port, Transit and Logistics Council to oversee the joint management of ports by municipal and State authorities (see Box 10). In practice, the Government exercises its oversight through the Ministry of Transport (which, similar to three other Ministries, is represented in the ports’ Boards).

**Box 10. The Latvian Port, Transit and Logistics Council**

The Council is chaired by the Prime Minister and comprises:

- Government representatives: (i) the Minister of Transport and two officials of this ministry; (ii) the Minister of Finance; (iii) the Minister of Economics; (iv) the Minister of Interior; (v) the Minister of Environmental Protection and Regional Development; (vi) the Minister of Agriculture; (vii) the State Secretary of the Ministry of Foreign Affairs
- Municipal representatives: the chairpersons of the city councils of Riga, Ventspils, and Liepaja;
- The CEOs of the ports of Riga, Ventspils, and Liepaja, and a representative of other ports;
- Representative of various public entities: the Latvian Development Agency, the Latvian Maritime Administration, a representative of the Seafaring Union, the Ministry of Defense, the Ports Association of Latvia, the Latvian Customs and Railways Administration (TBreC).

Professional associations can also attend the Council’s meetings, such as the Latvian Transit Business Association, the Latvian National Freight Forwarders and Logistics Association, "Latvijas Auto", the truckers association, the Latvian Logistics Association, the Latvian Ports Association, the Baltic Association for Transport and Logistics, and the Latvian Small Ports Association.

The Council is responsible for:

- Assessing draft policy planning documents and regulatory actions/initiatives that have an impact on development of Latvia’s port, transit and logistics sector; provide opinions on those drafts; and coordinate the developmental concept for the ports of Latvia;
- Putting forward proposals, related to Latvian foreign policy activities, aimed at Latvian ports, transit and logistics sector development;
- Encouraging and supporting the Latvian port, transit and logistics sector’s recognition in the international business environment and support Latvian ports’ participation in international exhibitions and conferences;
- Providing opinions regarding proposals to alienate immovable property in ports for State or public needs;
- Approving the use of the resources of the Port Development Fund; and
- Promoting the Latvian ports, transit and logistics sector development, coordinating cooperation between the parties involved and addressing common concerns.

The Council meets about seven times a year. The schedule is determined at the beginning of the calendar year with a tentative list of issues, which are added to and updated throughout the year.

---

67 According to the "State Administration Structure Law", “a derived public person” is "a local government or other public person established by law or on the basis of law. Such public person has been conferred its own autonomous competence by law, which includes also establishing and approving its own budget. Such a person may have its own property”. The "State Administration Structure Law" requires the form and content of the institutional subordination of derived public persons to “be determined by the law, by which or on the basis of which the relevant derived public person has been established.”
The Latvian Port, Transit and Logistics Council provides a proper mechanism to address some port and transit sector issues by bringing together public and private sector stakeholders. The Council coordinates implementation of the national policy related to the development of ports and their operations (the name of the Council also adequately reflects the fact that ports are just one node in longer supply chains). Meetings can be attended by the private sector, and the Council typically devotes a large share of its time to discussing concerns expressed by freight forwarders, road haulers, shipping agents, logistics companies, etc. The meetings are open to the media, hence ensuring a high degree of transparency (although formal minutes of the Council’s meetings could also be disclosed to the general public on the website).

Nevertheless, the Council often appears to be a discussion platform rather than a decision-making authority which could hold Port Authorities accountable. The Council’s decisions are not binding and its composition is such that the decision of the Prime Minister could theoretically be outvoted, especially by members representing the industry. Complaints about the Council’s decision can be referred to local courts. Overall, the Council is not equipped to provide effective oversight of the Port Authorities, and lacks the ability to enforce its decisions over the Boards or the CEOs.

Neither the Cabinet of Ministers, nor the Council nor municipalities have an institutionalized process to assess performance by the Boards, and hence to hold them accountable. There is no formal performance measurement process for the Boards, even though they bear the ultimate responsibility for the Ports’ performance. Bylaws for each of the Boards do not stipulate any mechanism to assess the way they discharge of their responsibilities and ensure effective supervision of the Ports. Because the Boards are not formally held accountable by any authority both the central government (through several ministries) and the municipal governments have always had their representatives on Boards in order to remain posted on the work and decisions of the Boards. However, these representatives are usually accountable only to their political constituencies or to the authorities which appointed them. As a result they are expected to reflect their constituency’s position and provide information to their constituencies, and do not always have incentives to look first at the general interest of the ports. This is a key weakness of the current port status. Another consequence of this setting is that they change as frequently as the central government (which changes frequently) or municipal governments (which have been very stable). The performance of individual Board members is presumably appraised by the authority which (s)he is representing, but this cannot substitute for an evaluation of the Board as a whole (and of the outcomes of its decision-making process) – especially considering the nature of the relationships between the various appointing authorities.

5.3. Supervision- The role of the Boards

The Boards constitute the “highest decision-making body” in Latvian ports. According to OECD Guidelines, public entities’ boards, not management, are assigned the ultimate responsibility for the organization’s performance and are accountable to relevant public authorities. Boards are expected to follow the best practices adhered to in the private sector to effectively perform their responsibilities and functions. Specific responsibilities of the Ports’ Boards in Latvia include the review and approval of: (i) the Ports’ regulations; (ii) the structure of the Port authorities’ executive; (ii) the Ports’ borders; (iii) the Ports’ development programs, (iv) the Ports’ marketing strategies; (v) the Ports’ annual and five-year budgets (including revisions); (vi) proposals for new leases (including fees) and issuance of permits for licensed commercial activities; (vii) contracts of a value over LVL 50,000 or a duration of more than five years; etc. The Boards of the Latvian ports perform only the function of the highest decision-making body but not the function of supervision in the ports.

132. **Several important features of Boards in Latvian ports diverge from international good practices.** These include the composition of the Boards, the profile of Board members, the duration of their tenure, and the role of committees. It is well understood that practices in each country need to reflect specific circumstances and arrangements, and that there is no “one size fits all” model for the functioning of ports boards. Nevertheless, the current practice in Latvia where the Board is not clearly accountable for results may have important implications on the Boards’ ability to ensure adequate supervision of the executive.

133. **First, Board’s composition.** The composition of landlord ports’ boards varies greatly across the world. Board members are typically appointed by relevant public authorities. Many boards have a preference for an odd number of members to facilitate decision-making in case of dissensions. Particular efforts are also made to ensure that boards include persons with strong experience in the private sector. An emerging trend is to ensure that board members are “independent” rather than “representatives” of an authority – i.e., that once appointed by a relevant authority they act and decide by themselves in the best interest of the ports rather than represent or defend the views and interests of an external party (see Box 11). By contrast, in accordance with the 1994 Law on Ports the Boards of Riga and Ventspils are composed of eight members: four representatives of the government (of the Ministries of Transport, Finance, Economics, and Regional Development and Environment respectively) and four representatives of the relevant municipal authorities. Ministries’ representatives are appointed by the Cabinet, and municipal representatives by the City Council. The boards consist of a large majority of members holding public offices and usually with limited private sector experience applicable in the port sector. Overall, the composition of the Boards and the appointment system create a risk of political interference (while paradoxically there is limited accountability to the political oversight body, the Latvian Port, Transit and Logistics Council) and do not guarantee the independence of Board members. This weakens the Boards’ ability to act as an effective supervision authority.

**Box 11. The notion of Independent Board Member**

(a) Adapted from Unlocking Your Board’s Full Potential: Board Evaluation Questionnaire, UK National Audit Office, ICAEW Non-executive board members Group, Mazars.

A Board member is not independent if s/he:

- Is a recent employee;
- Has a recent material business relationship with the company;
- Currently receives or recently received remuneration from the company (other than directors fee, share option or pension);
- Has close family ties with the company’s advisors, directors or senior employees;
- Holds cross directorships or has significant links with other directors through involvement in other companies or bodies;
- represents a significant shareholder; or
- has served on the board for more than nine years from the date of their first election.

(b) Advantages of Having Independent Members on Board

The UK’s “Modernising Trust Ports” suggests that “a move from representatives to independent board membership removes the need for a large and potentially ineffective board structure.” Having independent board members would enable to concentrate on achieving an effective balance of skills to

---

69 Of course no private sector board members should be an operator within the port, to avoid conflict of interests.

70 The Boards of smaller ports, including that of Liepaja Port, are regulated by a different provision (Section 26) of the same 1994 Law. It stipulates that the Board shall consist of not more than 10 members, including the undertakings (companies) operating in the port.
meet operational and strategic needs rather than on creating large boards. For instance, the Port of Sydney requires a board member to be independent in character and judgment, and have “no relationships or circumstances which could materially interfere with the exercise of independent judgment”. The Regulations for the Supervisory Board of Rotterdam port require “each of its members, with the exception of a maximum of one person, must be independent.”

134. **Second, Board members’ profiles.** Although board composition varies across the world, most performing ports seek a large share of board members with a private rather than public sector background and mind-set. This is aimed at encouraging a decision-making process based on an economic and financial rationale, rather than on politically driven considerations. It also reflects the fact that the port authorities are not government agencies and operate in a different environment thus requiring a different set of skills. In-depth technical experience in areas relevant to port management is also critical for Board members to be able to adequately assess the CEO’s reports and recommendations (see Box 12). The most common professional experience among board members includes shipping, railways or other transport modes, logistics, industry, nautical-maritime, and financing (while each Board member can only have limited professional expertise, the Board as a whole should be able to cover all critical areas of port management). In Latvia, applicable regulations do not explicitly spell out qualifications requirements for Board members. In practice, a brief review of current Board members’ backgrounds suggests that the level of experience and expertise may be variable. There is also a perception that political affiliation may at times trump professional skills. This does not facilitate the functioning of the Board as an effective supervision authority.

**Box 12. Qualification Requirements for Vancouver Port Board Members**

The Board members, as a group, should possess the following skills and experience, with each director contributing knowledge, experience, and skills in *at least two domains*:

- **Board Experience**
  - Previous experience as a director of a commercial or not-for-profit organization
  - Demonstrated knowledge of governance best practices

- **Strategic Planning**
  - Experience in preparing long-term strategic plans for sizeable commercial or not-for-profit organizations
  - Setting key performance indicators and monitoring processes

- **Financial & Risk Management Depth**
  - Experience in financial analysis, risk management and budgeting for a major organization
  - Depth in financial and accounting systems, internal controls, audit and risk management processes

- **Business Management / Leadership**
  - Experience in operating a large, complex business organization, including marketing, revenue generation, cost controls, recruitment and development of management team

- **Maritime Industry Experience**
  - Knowledge of and experience in the maritime industry, including transportation and logistics, terminal operations, shipping, rail and trucking services

- **Human Resources & Compensation**
  - Depth in human resource management, pension plan administration, labor relations, compensation policy, executive development and succession planning

---

71 Sample Board Skills and Diversity are available in UK’s Modernising Trust Ports:
• Major Capital Project Expertise
  o Depth in the processes of development and oversight of large capital projects, knowledge and experience in property management and real estate, including government and community relations

135. Third, duration of tenure. Most performing landlord ports in the world set term limits for their Board members, typically between three and six years (see Box 13) with the possibility of one reappointment. This is aimed at ensuring stability and at providing enough time for Board members to acquaint themselves in depth with the issues they are to decide on (by avoiding too rapid rotations) while at the same time bringing in “fresh blood” periodically and minimizing the risks of co-optation between Board members and the CEO or specific stakeholders (which could develop over long tenures). In Latvia, applicable regulations do not define such term limits for Board members. In practice, representatives of Ministries tend to be replaced with each change of government and current members have served from 9 months to two years. Municipality representatives, on the other hand, have been in the Board for two to over 15 years. This results in some unbalances and in a degree of instability. At times, Boards may also end up being dominated by a group of members who have been in place for a long period, which may create little space for challenging established arrangements and fostering new ideas. This makes it difficult for the Board to function as an effective supervision authority which can hold management accountable.

Box 13. What is the optimum number of years that members should serve on board?

Current practice in the UK (i.e., “UK’s Modernising Trust Ports” (2000, 2009)) stresses that anything less than three years inevitably hampers consistency and stability within the board, and that a more frequent turnover of board appointments may result in the loss of valuable ‘corporate memory’. It also notes that boards should seek to avoid a situation whereby all board appointments have a common term and end date, synchronised roll over being disruptive to the overall effective management and business of the port.

Global examples of Port board members tenure: New York and New Jersey: 6 years; Sydney: 5 years; Los Angeles: 5 years; Rotterdam: 4 years; and Vancouver: 3 years.

136. Fourth, committees including audit committee. Most performing landlord ports have established an audit committee within their Board. The audit committee is charged with oversight of financial reporting and disclosure. It is typically composed of three to four qualified members of the Board (with a Chairperson selected from these members). The audit committees are typically empowered to acquire the consulting resources and expertise deemed necessary to perform their responsibilities. Audit committees also oversee the internal audit function within the port authority, financial planning and reporting, the system of corporate controls, risk management, and develop recommendations to the full Board for approval. In Latvia, there is no practice of establishing such audit committees. This implies that Boards may not be as well-equipped as comparators to ensure an effective supervision of the Ports’ financing and control systems. In general Latvian ports, contrary to usual international practices, do not establish committees for specific purposes pertinent to the Port activities, especially audit or finance committees.
5.4. Management – The relationship between Board and CEO

137. The rights and obligations of the CEOs and the responsibilities of the Board with respect to the CEO are stipulated in the respective Port Authorities regulations. The CEOs’ responsibilities include: (i) implementation of the Boards’ decisions (including on contracts with private sector operators); (ii) implementation of the budget approved by the Boards; (iii) organization of the Board meetings and provision of the necessary materials; (iv) management of the Executive Body (Administration), hiring and dismissal of the employees, setting terms of reference and remunerations; (iv) management of the Port Authority’s financial resources and property (including preparation of one- and five-year budgets); (v) establishment of development plans and (vi) day-to-day operational management of the Port Authority. The Boards are responsible for reviewing the CEO’s actions and transactions.

138. In line with good practices, the CEOs report to the Boards on a regular basis. Applicable regulations require the CEO to provide the Board with a report “on the progress of collection of the Port charges, service fees and lease (rental) payments, the progress of implementation of the approved budget, and results of the economic activities” and the Board to review this report as well as “information about the CEO’s actions and transactions regarding matters within his competence”. In practice, both CEOs and Boards appear to fully comply with such requirements.

139. To ensure an effective management of the ports, CEOs ought to be held accountable by the Boards for their performance. This is routine practice across the world, and indeed it is the foundation of effective corporate governance. The process is typically based on an evaluation of the CEO’s performance, against detailed terms of reference and pre-agreed evaluation criteria (or goals and quantitative targets set for the organization). At this stage, there does not appear to be such a formal process in Latvian ports, which makes it difficult to assess how well management is performing and agree on areas for improvement. Most landlord ports also have explicit term limits for their CEOs (and criteria for their selection and / or re-appointment) so as to facilitate the replacement of a non-performing executive. In this area, practices in Latvia are in line with international practices, where a number of ports CEOs tend to have relatively long tenures (through repeatedly renewed appointments).

5.5. Audits

140. The carrying out and full disclosure of regular (at least annual) external audits – both operational and financial – are critical to ensure a sound use of public assets and resources as well as to develop a sense of accountability. Financial audits are the norm in most landlord ports in the European Union and beyond. They need to be carried out by a specialized external firm and to be effectively reviewed by the Boards, with a view to taking action to remedy observed deficiencies. Audits by the State Audit Office (SAO) may complement this work – but are not a substitute. Good practice also requires that findings and recommendations of such audits be made public and widely available. Ventspils does not publish external audit reports, while Riga publishes only condensed version of the external audit report, which is not consistent with good practices in other advanced ports. Transparency in relation to audits is therefore lacking.

141. The unavailability of annual operational audits in the Latvian Ports is a weakness in governance and accountability systems. External financial audits which are carried out annually in Latvian ports are disclosed only in condensed versions. While financial audits reviews the financial statements, resulting in publication of an independent opinion on whether these financial statements are relevant, operational audits review the efficiency and effectiveness of operation and determine if there is a risk that public resources and assets may be misused or ineffectively used. Operational audits can also typically be used in conjunction with the KPI/Targets set by the boards to the Port management (or by the government to
the Port) in terms of operational efficiency. The issue in Latvian ports is both with the regulations (which do not mandate such audits) and with current practices.

**Box 14. Internal control system, internal and external audits**

The term “internal audit function” is defined in International Standards on Auditing (ISA) 610 as: “an appraisal activity established or provided as a service to the entity. Its functions include, amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of internal control.” The term “internal control” is defined in ISA 315 as “the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity’s objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.” An internal control system comprises the following components:

| The control environment | Governance and management functions  
| Attitudes, awareness and actions of management  
| “Sets the tone” by creating a culture of honesty and ethical behavior  
| Provide an appropriate foundation for the other components of internal control  |
| The entity’s risk assessment process | How management identifies risks and decides upon actions to manage them  |
| The information system | Consists of infrastructure, software, people, procedures and data  
| The related accounting records, supporting information and specific accounts in the financial statements that are used to record, process and report transactions  |
| Control activities | The policies and procedures that help ensure that management directives are carried out.  
| The categories most relevant to an audit are:  
| Performance reviews  
| Information processing  
| Physical controls  
| Segregation of duties  |
| Monitoring of controls | Assess the design and operation of controls over time  
| Ongoing monitoring is part of regular management activity  
| Separate monitoring may be performed by the internal audit function  |

External auditors are obliged to have an understanding of the business risks which are grouped in three categories (a) financial risk; (b) operational risk; (c) compliance risk. They are obliged to assess the internal control system in accordance with the ISA. If an external auditor finds some deficiencies in the internal control system they should report these findings with recommendations to the management and supervisory bodies (e.g. audit committee if existing). In accordance with ISA 610 (Revised), the external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor’s use of the work of the internal audit function on the engagement. Although the function may perform audit procedures similar to those performed by the external auditor, neither the internal audit function nor the internal auditors are independent of the entity as is required of the external auditor in an audit of financial statements in accordance with ISA 200. The objectives of the external auditor, where the entity has an internal audit function and the external auditor expects to use the work of
the function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor are:
(a) To determine whether the work of the internal audit function can be used, and if so, in which areas and to what extent;
and having made that determination:
(b) If using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit.

**Recommendations**

**Legal Framework**

142. **The Government of Latvia should consider changing the legal status of Latvian ports to public companies under the law on public corporation.** The change of the legal status would not only allow better aligning the institutions to the nature of their business, but also change the incentives structures for Board and management members as well as bringing ports’ management and governance practices under the discipline of corporate law. While changing status is never a guarantee that everything will change for the better, corporation status is clear on the role of the boards, and usually separates the role of the State (or the Municipality) as a shareholder (which provides the main orientations and strategy and acts through the shareholders assembly) from the executive role of the board itself for management decisions. The Derived Public Person status does not prevent the use of similar transparency, accountability and control mechanisms as usually experienced in companies but requires additional processes and procedures to be implemented, while a change in the status gives the government flexibility to refer to standard corporate governance principles, and to determine the accountability of the boards and their roles. The joint ownership/control of the port by municipalities and the State is also possible under this system.

**Box 15. Benefits gained by the Port of Rotterdam Authority after the change of its legal status**

The justification for the above recommendation is supported by the confirmed benefits which the Port of Rotterdam Authority has gained with the change of its legal status to “corporation structure” in 2004.


“The Corporation structure combined with a Landlord Port model means the organisation is publicly owned but commercially driven. Adopting a corporation structure was very important in terms of funding and financing. It transformed the Port Authority into a fully commercial organisation, while retaining the authority and powers necessary to be a fully effective ports manager. It allows the Authority to focus on operations without undue day to day political involvement. The Authority is not as dependent on local politics as it was and there is no need now for locals to approve port expenditures. (…) Its corporate structure also provided the Authority with greater commercial freedom, including the ability to invest elsewhere. The Authority has investments overseas (e.g. a 50 percent shareholding in Oman), undertakes consultant studies on a commercial basis, etc. Importantly, it is required to meet Corporations law requirements for transparency, information disclosure and public reporting.”

143. It is important to note that many of the recommendations (e.g., transparency and disclosure of information, conflict of interests, selection of board members, etc.) in this and other chapters do not depend on the change of the legal status of ports (unless it is indicated otherwise).
**Oversight and general structure**

144. *The role of the Latvian Ports, Transit and Logistics Council should be strengthened in improving efficiency of the system.* The Council plays an important role as a facilitation and discussion forum. It could become a catalyst to ensure synergies between stakeholders to establish an efficient transit corridor (e.g., by looking at institutional arrangements for coordination of strategic and day-to-day decisions across the supply chain: ports, railways, border-crossing, and other relevant government agencies; or by looking into issues of customs, regulatory and other bureaucratic obstacles to efficient and reliable cross-border movements). Given that the Council's members also comprise government officials, the Council is currently the only structure which could play catalyst role that federates and facilitates the implementation of the measures needed to ensure improvements. This would require, however, that the Council be granted authority to make binding decisions, typically in those areas related to coordination of processes between all stakeholders or to solve major operational issues. The current memberships in the Council seem to be sufficiently balanced with a prominent role to the public sector to allow such a change without risking vested private interests to capture the decision making processes. Formal minutes of the Council’s meetings should also be disclosed to the general public on the website to comply with the Freedom of Information Law (1998).

145. *An oversight function should be established to hold the Boards of Latvian Ports accountable and to carry out an annual evaluation of their performance.* Four governance structure options could be considered to ensure a global oversight of boards’ performance: (i) the State (through one or several ministries); (ii) the respective Municipalities; (iii) the Latvian Port, Transit and Logistics Council; or (iv) converting the incumbent Boards into Management Boards that will fully consist of professional individuals, and creating Supervisory Boards of the Ports that will oversee the Management Boards. Options (i), (ii) and (iv) are widespread over Europe. Table 16 summarizes the pros and cons of the various schemes. It has to be noted that a change in law is necessary in most of the options and would be easier to implement in a context where, the legal status of port authorities will have to be changed from a derived public person to a public company under law on public corporation. In most cases the selection method and appointment methods for board members should also be revised.

**Table 16. Options for institutional arrangements to perform an oversight of the Boards**

<table>
<thead>
<tr>
<th>Options</th>
<th>Pros</th>
<th>Cons</th>
</tr>
</thead>
</table>
| The State as an oversight body | • The State may have most of needed skills for oversight; it will orient the Ports’ contribution to the national economy, and increase synergies between several ports. It is also in a good position to review main decisions that have fiscal and public investment impact and can adjust fiscal policy depending on the situation.  
• A unique structure in charge of oversight makes it easier to provide overall directions. | • Municipalities are not involved, and would not feel that they can influence the ports contribution to the local/regional economy  
• It would require changes to the Law clarifying this supervisory function and management function and can be an issue for oversight of the part of the board that is not appointed by the government (if there is no change in the appointment process). |
| Municipalities as an oversight body | • The Municipalities would be in a better position to oversee the Port’s contribution to the regional/local/municipal economy. In the case of Riga, it could increase | • The municipality may lack skills to provide overall evaluation of the board’s operation given the specificity of the port sector.  
• The overall national interest may be |
the integration of the port within the city and clarify how to carry out relocation of activities outside the historic center.
- A unique structure in charge of oversight makes it easier to provide overall directions.

| Latvian Port, Transit and Logistics Council | partially lost including complementarities between ports.
| | • Oversight of the part of the board which is appointed by the state may be a problem if there is no change in appointment processes.
| | • Most transparent and most inclusive/representative body given its diverse membership
| | • No need to create an additional institution.
| | • It can include both the national and local interests as well as the views of the private sector.
| | • Its current status of a discussion platform and lack of binding decision-making power would prevent the Council from having an impact on performance of the Boards if there is no change in law.
| | • Some existing members of the logistics council would have conflicts of interest (operators which benefit from existing concessions or authorizations within the ports), while removing private operators from the council would make it lose part of its discussion platform function.

| Newly established Supervisory Board as an oversight body and conversion of the existing Board into Management Board | • Institutional set up similar to that of public companies (where the supervisory board would have a role similar to that of a shareholders assembly) and which functioning could easily be established based on companies’ governance model.
| | • Supervisory Board could consist of representatives of the State and Municipalities and maintain the joint oversight by municipalities and government without interference of third parties.
| | • The existence of the supervisory board with political accountability would ease the selection of management board on the basis of professionalism criteria.
| | • It would require amendment to the Umbrella Law, most likely transforming the ports into public companies.
| | • Contractual arrangements should be established between Supervisory Board and Management Board.
| | • Municipalities and government may feel that they have less grasp on the day-to-day activities of the port (which others can consider as a positive factor).
| | • Selection and composition of management board members would need to be reviewed

146. The annual evaluation of Boards’ performance should be undertaken by this newly established oversight body. In many countries, there is a mandate/contract between the board and the oversight authority and this could be the basis of such an evaluation against their mandate, main responsibilities, and compliance with the prevailing corporate governance framework. Such an evaluation could be done directly by the oversight body or with the support of external consultants. Recommendations from this evaluation exercise to improve the Boards’ performance should be developed and made public.
Supervision

147. The Cabinet of Ministers should amend the relevant bylaws (regulations) to clarify the required qualifications for Board members. This should encourage authorities to ensure that selected board members have adequate experience and skills to fulfill their mandate. The bylaws should provide a Board member’s profile including general attributes (e.g., independence, accountability, integrity, leadership, etc.) and specific professional qualifications for some of the board members (e.g., skills, knowledge and experience in a specific area of expertise). Relevant backgrounds would typically include: finance, marketing (especially with experience in the CIS), shipping, logistics/freight forwarding, railways, terminal operations, legal services.  

148. The Cabinet of Ministers should also amend the relevant regulation to introduce term limits for Board members. Terms limits should include a standard period of tenure (say 4 years) as well as a maximum number of terms (e.g., two terms). It should be expected that Board members serve their full tenure, even in the case the appointing authorities change (as these are technical, not political, positions). If such principle is selected, then the introduction of new members should be phased (e.g. renewal of the Board by half every second year).

149. Boards should establish Audit Committees. The Committees’ responsibilities should involve oversight of: (1) the financial reporting and financial position of the port authorities; (2) the system of internal controls and risk management; (3) the internal audits; (4) the external audit. The audit committee should be composed of two to four Board members, with adequate professional background and qualifications. The identity of the audit committee’s members should be disclosed on the Ports’ websites. An audit committee charter should be developed to describe the powers of the audit committee and should be approved by the Board and disclosed on the websites.

Management

150. The Cabinet of Ministers should amend the Ports’ bylaws to mandate an annual evaluation of the CEO’s performance. This will require developing detailed Terms of Reference as well as setting qualitative or quantitative goals on an annual basis. The evaluation of the CEO performance should inform any decision on his/her remuneration. A summary of the evaluation of the CEO performance should be made public.

Audits

151. The Cabinet of Ministers should amend the relevant bylaws governing the Ports to carry out, disclose external audit reports of each Port in full and full responses to these reports in order to increase transparency around the financial audits and their results. As it the case today it should be specified that the financial audit be carried out in accordance with International Standards on Auditing (ISA). The audit committee of the Board should oversee the tender process for the recruitment of an independent auditor; the Boards should discuss the results of the audits and agree on a time-bound

72 (i) Sample TORs and advertisement for new port board members adapted from UK’s Modernising Trust Ports is available at: http://core.kmi.open.ac.uk/download/pdf/84286 (ii) A definition of not an independent member of Rotterdam Port Supervisory Board is available in Rotterdam Port's Regulations: http://www.portofrotterdam.com/en/Port-authority/organisation/Documents/rules_supervisory_board.pdf
73 (i) Sample Charter of Audit and Risk Committee of the Port of Sydney is available at: http://www.sydneyports.com.au/corporation/corporate_governance/audit_and_risk_committee_charter (ii) Sample Charter of Audit Committee of the Port of Seattle is available at: http://www.portseattle.org/About/Commission/Audit-Committee/Documents/Audit_Committee_Charter_20121211.pdf
74 Sample job description of port CEO is also available at: http://www.portskillsandsafety.co.uk/skills/careers/industry_roles/port_manager
75 The audit committee should develop guidelines on the engagement and ensuring the independence of the external auditor and report to the oversight authorities on the actions it has taken to safeguard the independence of the auditor. A number of different approaches may be employed
action plans to remedy observed deficiencies; and that the key findings and recommendations of the audit, as well as the Board’s action plan, should be published and made broadly available. The external audit reports shall be published in full and a comprehensive response including a time-bound action plan to correct observed deficiencies.

152. **Operational audits should be conducted in parallel with standard financial audits.** Such audits would allow the boards (and the government and municipalities) to have a better grasp at the efficiency of investment and of operations including their costs. Operational audits would also use technical skills that can assess port operations that are usually not present in the administration itself and diminish the asymmetry of information between the ports and their oversight bodies.

153. **An internal audit function shall be established in each port and report to the board.** Such a function would be useful in order to increase discipline in asset management and cost control.

Background

154. Latvian ports play an important role in the national economy. Latvia has long established itself as a transit country (mainly for Russia, Central Asia, and Belarus) and its ports handle more than 60 million tons of cargo per year. The main ports are Riga and Ventspils (and to a lesser extent Liepaja). Overall, logistics activities account for thirteen percent of GDP (and were relatively resilient during the 2008-2009 crisis).

155. The sector is governed by the 1994 Law on Ports (and subsequent amendments and complementary laws such as the 2000 Freeport of Riga Law, the 1997 Freeport of Ventspils Law, etc.). Port Authorities are established as public entities, which enter into contractual agreements with private operators for land use, development of activities and in some cases general (common) services. For each port, the Port Authority is supervised by an eight-member Board (four representatives from the municipality and four representatives from the Government). The law also provides for a National Ports Council consisting of representatives of the State, the ports and the concerned Municipal Councils which oversees sector policies at the national level.

156. Concerns have recently emerged over the competitiveness of the Latvian ports – and how to maintain and further improve it in an increasingly difficult environment. Traditional competitors of the Latvian ports include Klaipeda and Tallinn, as well as St. Petersburg and Primorsk. The recent development and rapid growth of Ust-Luga, however, may alter the equation, by absorbing an increasing share of the trade with the Russian hinterland. In parallel, the Latvian authorities would like to position the ports in such a way that the share of high value added activities can gradually increase.

157. As part of the competitiveness agenda, the authorities are also interested in strengthening ports governance. In this respect, there are discussions on how to best set objectives and incentives for the ports’ management; how to ensure fair competition among operators and fair pricing of ports services; how to manage port operations under public law vs. corporate law; etc. The Government committed to the European Commission “to review ports’ taxation regimes (special economic zones) and make efforts to increase the effectiveness and transparency of their governance”.

158. In a letter dated June 22, 2012, the Ministry of Transport requested World Bank support to carry out a review of the sector. A World Bank mission visited Latvia on August 29-31, 2012, to discuss the possible scope of such a review, and had the opportunity to engage with the Government, Parliamentary leaders, ports authorities, and private sector representatives. These terms of reference reflect the substance of these conversations.

Objective

159. The objective of the study is to review the operations and management of the main ports of Latvia, and to make recommendations, if / as needed, (i) to strengthen the ports’ international competitiveness and (ii) to ensure their governance practices are in line with good international experience.  


---

76 For the Purpose of this study, Governance refers to the framework of rules and practices by which the board ensures accountability, fairness, and transparency in a company's relationship with its all stakeholders (financiers, customers, management, employees, government, and the community) The governance framework consists of (1) explicit and implicit contracts between the Ports and the stakeholders for distribution of responsibilities, rights, and rewards, (2) procedures for reconciling the sometimes conflicting interests of stakeholders in accordance with their duties, privileges, and roles, and (3)
**Methodological approach**

160. The review will focus on the regulatory framework of the sector, including its actual implementation and interpretation, and the existing sector strategies and strategies for the development of the main ports, including the contemplated investment programs. The study will be carried out on the basis of data analysis and discussions with stakeholders.

161. The study will be based on a comparison of applicable rules and actual practices and performance in Latvia with existing arrangements in comparable port entities in other countries. With regard to governance, the study will focus on sharing good international practices (which are relevant for Latvia) and is not expected to dwell on specific incidents or allegations. To identify possible areas for improvements, the study will rely primarily on benchmarking with relevant comparators and consistency with international norms. To make recommendations, the study will primarily review relevant experience in other countries and adjust it to the Latvian context.

162. The study will focus on the ports of Riga, Ventspils, and to a lesser extent Liepaja, within the broader context of the Baltic Sea trade. Whenever relevant, findings and recommendations will be disaggregated for the two ports of Riga and Ventspils.

10. The study will cover two main areas: (i) Competitiveness and (ii) Governance. Work in both areas will proceed at the same time as competitiveness is strongly linked to governance.

**Competitiveness**

11. With regard to competitiveness, the review is expected to cover the following areas:

- **Performance indicators** – review of international practices to measure ports’ and port authorities’ performance and progress towards increased competitiveness (to provide incentives for maximizing the ports’ contribution to the development of the national economy); review of the key performance indicators (KPIs) is done bearing in mind that the majority of the port’s cargo is bulk cargo handled at a large number of terminals and that most of the cargo is transit cargo – recommendations on possible sets of indicators for each of the main Latvian ports.

- **Logistics Performance Index** – review of Latvia’s performance on the World Bank’s Logistics Performance Index, and the different activities that make up the Index, strengths and areas for improvements – identification of priority actions to improve performance as relevant.

- **Short- to medium-term competitiveness** – brief review of emerging trends and prospects for both sea trade in the Baltic region and alternative trade routes for Latvia’s main hinterland (Russia, Asia, and Belarus) – review of the Latvian ports’ comparative advantages (strengths and weaknesses) over their main competitors – benchmarking of Latvian ports (based on above performance indicators) – review of Latvian ports’ strategies aimed at attracting traffic and investment in the coming years – comments and recommendations.

---

procedures for proper supervision, control, and information-flows to serve as a system of checks-and-balances. (Source: OECD Principles of Corporate Governance)
• Medium- to long-term development – review of international experience with adding value to cargoes while in transit through Latvia’s ports, to generate spin-off activities around the port sector, to develop logistics hubs, and to maximize the ports’ impact on the overall economy – recommendations.

• Business facilitation – review of actual arrangements and practices for the port authorities to facilitate business by the private sector (importers, exporters, investors, etc.) – benchmarking with comparable port entities in other countries – recommendations.

• Investment program – review of the Latvian ports’ investment strategies, including in the context of preparing for the next EU financial perspective – assessment of their consistency with short-, medium-, and long-term competitiveness objectives – recommendations.

Governance

12. With regard to governance, the study will focus on transparency and accountability in port sector management by reviewing Latvia's practices and sharing good international practices. It is expected to cover the following areas:

• Linkages between competitiveness and specific aspects of governance – lessons from international experience – implications on priorities for reform and rationale for change.

• Oversight structures – review of the institutional and legal framework for port oversight, the structure, composition, role, and actual functioning of the boards (including contractual and performance measurement arrangements and prevention of potential conflicts of interests) – review of board oversight arrangements for activities affecting the use of large amounts of resources – review of the oversight role of the Latvia Ports Council and of the Ministry of Transport – review of the consistency with international guidelines and comparison with practices in comparable port entities – identification of strengths and weaknesses; and recommendations.

• Port management – review of the responsibilities of the Chief Executive Officers – review of internal processes and procedures as well as internal and external control mechanisms (e.g., for financial management, contracts management, performance measurement, etc.), including consistency with actual practices – review of the consistency with international guidelines and comparison with practices in comparable port entities – identification of strengths and weaknesses; and recommendations.

• Relationship between port authorities and private operators – review of applicable regulations and actual practices with regard to neutrality / fairness on decision-making (including investment authorizations, space allocation, security / predictability of contractual arrangements, contracting of general services and administrative matters) and pricing of services – review of applicable regulations and actual practices with regard to the port authorities’ involvement in services that could be contracted out to the private sector – review of the consistency with international guidelines and comparison with practices in comparable port entities – identification of strengths and weaknesses; and recommendations.

• Financial flows between the port authorities and the State – review of various international models (including their relation to a given structure of traffic in perspective to port competitiveness), and the corresponding strengths and weaknesses, risks and opportunities – review of actual practices in the case of the Latvian ports – review of the methodology used to calculate rates of returns for ports’
investments – assessment of the “value for money” for the State which derives from the current set up – review of the consistency with international guidelines and comparison with practices in comparable port entities – identification of strengths and weaknesses; and recommendations.

- *Transparency* – review of international good practices on the publication / communication of information by port authorities (what? to whom? how?) and measures taken to maintain commercial confidentiality (what should / should not be disclosed?) – brief comparison with practices in Latvia – review of the consistency with international guidelines and comparison with practices in comparable port entities – identification of strengths and weaknesses; and recommendations.
Annex 2. References