



IFICIL

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FOREIGN INVESTORS'
COUNCIL IN LATVIA

POSITION PAPER ON LEVEL PLAYING FIELD

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EXECUTIVE SUMMARY

Although much has been done towards ensuring an equal playing field, there is still unfinished work to be done in order to improve the business environment.

In order to attract foreign investment and ensure economic growth, it is essential to achieve fair competition for all market participants. Investors are still concerned about issues such as high levels of the shadow economy, non-transparent decision-making processes of regulators, unfair competition from state-owned companies and public procurement processes. The high shadow economy that has been on the rise since 2016¹, the continuously slow adaptation to innovative procurement procedures and issues with governance over state-owned and municipality-owned companies² damage the much-needed credibility for the business community and has a negative impact on fair competition, thus hindering progress in attracting new investments.

¹ <https://www.sseriga.edu/shadow-economy-index-baltic-countries>

² State Audit Office found that objectives for municipality-owned companies to be achieved with the participation of the municipality have not been defined, so in many cases, there is uncertainty about whether municipalities should continue to engage in commercial activities.

In an already uncertain environment for investors, it is essential to work hard towards establishing fair, balanced, open, and clear rules for all businesses operating in Latvia or those wanting to enter. In this sense, FICIL recommends addressing three main areas. Firstly, implementing real measures to effectively reduce the shadow economy, which clearly show that such practices are non-tolerable, while also motivating good taxpayers. Secondly, working on modernising and improving the competency of the public sector officials responsible for public procurement processes. Lastly, to increase the efficiency of state and municipality-owned companies by addressing the lack of operation synergies, reducing political influence, and complying with good governance standards.



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RECOMMENDATIONS

Combating the shadow economy

- Introduce unified governance over combatting the shadow economy, assigning the Ministry of Finance as the central institution for coordinating and driving the fight against the shadow economy while assuming accountability over the results.
- Ensuring transparency in cash circulation by introducing salary payments via bank transactions. Increasing transparency and monitoring triggering factors for the cash circulation "market".
- Expanding the means of proof to reduce feelings of impunity. Use of different policies, such as "tax invoices" to effectively decrease "envelope wage" payments and adopting measures for annual general income declarations.
- Increasing the transparency of the State Revenue Service (SRS) by publishing their "risk criteria", while continuing to increase their capacity and making it mandatory to adhere to the specific KPIs on activities and results that are benchmarked against the tax administrations of other countries.
- In cooperation with the private sector, improve regulation to combat the shadow economy in the manufacturing, construction and building materials sector, specifically, in the area of residential housing.
- Create a policy that favours and fosters honest business practices by creating benefits for the "good" taxpaying businesses.

Improving the public procurement process

- Centralise and encourage closer cooperation in public procurement processes among public sector officials from different institutions.
- Implement the necessary changes and adopt practices to foster a wider framework for evaluating public tenders.
- Establish a less formalised and more meaningful reliability assessment system for bidders to address the root cause of the issues. To facilitate this, "self-cleaning" measures should be overhauled to address the root causes of infringements.

Increasing efficiency and economic progress of state-owned companies

- Evaluate and address inefficiencies that arise from state representatives overseeing multiple state-owned companies. Introduce organisational or financial consolidation to create operational synergies.
- Implement transparent procedures for the selection of supervisory board members, ensuring they have the necessary skills and resources to independently supervise company management and affairs while minimising political influence in guiding company management.
- Improve corporate governance, transparency, and accountability by enabling state and municipality-owned companies to access public capital markets.

RATIONALE FOR RECOMMENDATIONS

Introduce unified governance over combatting the shadow economy, specifically, the Ministry of Finance taking on the central role in coordinating and driving the fight against the shadow economy while also assuming accountability over the results.

FICIL continues to emphasise **the need for unified governance over combatting the shadow economy, specifically, for the Ministry of Finance to take on a central role in coordinating and driving the fight against the shadow economy while also assuming accountability over the results.** This year, steps have been taken in the right direction with the Ministry of Finance assuming the role of coordinator while developing and presenting the “Shadow Economy Reduction Plan 2024 – 2027”³. During the development of the plan, specific priority sectors and ministries were assigned responsibilities for creating actions and implementing them⁴.

Nevertheless, there seems to be a lack of clearly defined accountability over the achieved results, and FICIL sees that the Government has not yet assigned effective administrative tools and measures for the Ministry of Finance to drive and oversee implementation of actions to reduce the shadow economy that are taken by other public sector institutions. Such tools and measures would empower the Ministry of Finance to directly entrust and influence, as well as supervise, the activities of the respective institutions in areas aimed at reducing the shadow economy. **FICIL continues to reiterate the need to proactively review and assess the allocated resources, including human resources, to combat the shadow economy effectively, and overseeing whether these resources are employed efficiently to achieve real results.**

In general, accountability, quality governance and transparency can lead to a reduced desire to operate in the shadow economy⁵. To foster this, FICIL believes a clear top-down approach at the highest political level is needed, prioritising combatting the shadow economy. In the previous Government led by Prime Minister Kariņš, only 3 tasks out of the 328

in the Government Declaration⁶ were directly related to reducing shadow economy levels. If there is no political willingness to accelerate a reduction in the shadow economy, then a substantial decrease in the current high levels is unlikely, as has been the case for Latvia⁷. **FICIL believes there should be clear and ambitious KPIs for state institutions on reducing the shadow economy levels. The Government should task the public sector institutions and municipalities as separate entities to carry out an assessment of their own activities and processes and identify those that have potential shortcomings to restrict the shadow economy and take (or delegate) the necessary actions to improve this.**

Limiting cash circulation and transactions - salary payments via bank transactions. Increasing transparency and monitoring the triggering factors for the cash circulation “market”

The Ministry of Finance created a work group that focuses on measures for restricting cash flow in different transactions, which was a step in the right direction both to find solutions and foster horizontal cooperation. However, FICIL believes that a clear priority should be given to tasks that have a significant impact on reducing shadow economy levels. Moreover, **FICIL also highlights the importance of effective monitoring mechanisms, including measures for the State Revenue Service to have access to necessary information.**

FICIL continues to recommend that Article 70 of the Labour Law is amended, which provides that salaries should be paid to employees in cash and that bank transfers are possible only by special written agreement. This is an outdated concept that fails both to reflect the business reality and encourages the shadow economy. **FICIL proposes reversing the respective provision by stating that salaries should be paid via bank transfer by default, and cash payments are possible only by special written agreement between employer and employee, and when complying with a set of objective criteria.**

3 Ēnu ekonomikas ierobežošanas plāns 2024.-2027. gadam

4 Par Ēnu ekonomikas ierobežošanas plāna 2023.-2025. gadam izstrādi

5 <https://onlinelibrary.wiley.com/doi/epdf/10.1111/boer.12330>

<https://assets.researchsquare.com/files/rs-2621229/v1/e26ca924-454f-4c0b-9a0c-54ae73c16619.pdf?c=1686771835>

6 <https://likumi.lv/ta/id/341317-par-valdibas-ricibas-planu-deklaracijas-par-artura-krisjana-karina-vadita-ministru-kabineta-iecere-to-darbibu-istenosana> 25. 137. and 142.

7 <https://www.sseriga.edu/shadow-economy-index-baltic-countries-in-2018-24,2%while-in-2022-26,5%>.

In FICIL's view, although such amendments would be an integral signal about what the state considers to be desirable behaviour, it only partially solves the task of reducing the shadow economy. **In order to strengthen the function of combatting the shadow economy, FICIL proposes the creation of a list of objective criteria on the basis of which the employer and the employee could agree on payment in cash,** for example, where the location of work is far from the nearest city, ATMs are not available near the workplace⁸, no bank account⁹ or other. A similar policy has been adopted by other countries, such as Finland¹⁰.

FICIL suggests introducing and strengthening the measures and obligations for credit institutions to report to SRS about retail bank accounts in different situations, for example, where a person withdraws or cashes in more than EUR 2,000 in a single month several months a year. This would reduce the sense of "invisibility" for those making hefty cash payments to buy, for example, cars or pay for construction work, and bypassing taxes. Such data, along with an appropriate information campaign, would **pre-emptively discourage persons from making large cash transactions** without the need for SRS to carry out a detailed examination for each case. Nevertheless, it is also imperative that the SRS acts on receiving this data and information, so it is not just a "box-ticking" exercise, but a practical approach to deal with individuals who contribute to increasing the shadow economy. In addition, FICIL would encourage state institutions and non-commercial state-owned companies to look at options for receiving payments from customers by bank transfer only, thereby limiting the shadow economy opportunities and also saving taxpayer resources on cash handling/administration.

Expanding the means of proof to reduce feelings of impunity. Use of different policies, such as introducing tax invoices to effectively decrease "envelope wage" payments and measures for annual general income declarations.

During the last couple of years, the sentiment among businesses and also the general public regarding perceived impunity for tax evasion has not changed and is still distinctively negative. FICIL has already indicated in its previous position papers¹¹ that the Government needs to increase the overall sense of the inevitability of punishment for economic

and financial crime in the society, including cases involving tax violations. One of the most effective means of achieving this would be criminal liability and convictions for tax evasion. The current situation of the number of initiated criminal proceedings and court rulings in comparison to the proportion of the level of "envelope wages" is disproportionately small. This is alarming and there is a need for immediate adjustments. FICIL maintains the position that the policy-makers should review the current system of liability for tax evasion by involving the public and private sectors to assess the use of indirect evidence in tax evasion cases.¹² FICIL conceptually supports the new instrument in the proposed amendments to the Law "On Taxes and Duties"¹³ - the tax invoice for mandatory state social insurance contributions and personal income tax according to publicly available information regarding salaries in the specific sectors, when several criteria signal the presence of "envelope wages".

Circumventing the penalty by dissolving the business

One concrete example of a situation that allows companies to dissolve instead of paying fines, as a result, is circumventing the penalty. Since 2005, the Criminal Law of Latvia provides for the possibility to apply coercive measures to legal entities for any crime, for instance, tax evasion, smuggling, bribery, money laundering, etc. **Coercive measures may include liquidation, limitation of rights, confiscation of property and recovery of money.** On November 3, 2022, extensive amendments to the Criminal Procedure Law became effective. Among other things, it was stipulated in the law that criminal procedures cannot be commenced, or an opened criminal procedure must be closed, as soon as a legal entity is liquidated against which there is an ongoing procedure for the application of coercive measures. In practice, the said amendments have become a handy tool for the legal entities to avoid any liability for the crimes which have been committed in their interest, for their benefit or due to their poor management. Firstly, legal entities are often liquidated either before any official resolution is passed to commence procedures to apply coercive measures, or shortly before any final resolution is passed on any specific coercive measure or their combination to be applied to the legal entity in question.

8 The unavailability of ATMs may be an argument for ensuring cash costs in very rare cases. The ATM network is extensive throughout Latvia and data on their availability have been published. Data on citizens' habits are also available, for example, on average 42% of bank customers do not withdraw cash at all, while on average 30% of bank customers withdraw cash up to EUR 200 per month.

9 There are very few such persons in Latvia, according to the data of the ECB's 2022 study, 93% of adults in Latvia have a bank account.

10 <https://www.lexology.com/commentary/employment-immigration/finland/dittmar-indrenius/salary-must-be-paid-into-employees-bank-account>

11 https://www.ficil.lv/wp-content/uploads/2021/09/FICIL_Econ_Crime_ENG_2021.pdf

12 https://www.ficil.lv/wp-content/uploads/2022/09/FICIL_PP_Shadow_Economy_EN_2022.pdf

13 Amendments to the law "On Taxes and Duties" (Nr.2/Lp14).

Secondly, new legal entities with the same or a substantially similar ownership structure, management and commercial activity are established soon after, operating in the same manner. Consequently, the work of law enforcement institutions worth several months or years is rendered meaningless. To prosecute the newly established legal entities, practically all investigative work must be performed anew. To address this issue, FICIL encourages high-level discussions among the Ministry of Justice, Prosecution Office, Supreme Court, Latvian Bar Association, and other stakeholders to look for solutions to end this practice. **FICIL encourages the use of such interim measures prohibiting the dissolving of the companies involved in criminal proceedings and registering a note with the Register of Companies prohibiting liquidation of the company during the period when crimes have allegedly been committed in the interests or for the benefit of the legal entity, or due to its poor management.** Moreover, FICIL requests the exploration of options to use “the transfer of the undertaking” similarly, as envisaged by the Commercial Law and already used in practice by the State Revenue Service. This instrument would impose liability on the legal entity, to be incorporated following the liquidation of that legal entity, which allegedly could have faced application of coercive measures. If the law enforcement institutions were not obliged to discontinue criminal procedures due to liquidation, but instead were granted with the option to make use of the transfer of undertaking, the feeling of impunity would be reduced.

Use of indirect evidence

FICIL also encourages public discussions regarding the use of indirect evidence in the criminal cases for tax evasion and paying envelope salaries (Articles 218 and 217.¹ of the Criminal Law). From the previous communication with law enforcement authorities, FICIL has concluded that a significant obstacle to the effective prosecution of persons for tax evasion reasons, is the difficulty in obtaining the direct evidence of the committed violation (for example, recording the moment that the payment of an “envelope salary” took place)¹⁴. Therefore, FICIL proposes reviewing the current system of liability for tax evasion by involving professionals from the public and private sectors to discuss expanding the use of indirect evidence in proving guilt in cases of wrongdoing¹⁵.

Non-differentiated approach when punishing wrongdoers

Although FICIL conceptually agrees with the position of the tax authority that the fight against the shadow economy is aligned to the risk-based approach, devoting the most resources to sectors with the highest risk and potentially the highest opportunity to increase tax payments should not automatically mean increased control of the activities of the largest companies. It is essential to take effective and strict monitoring and prevention measures not only against the largest companies in certain sectors, who are often the largest taxpayers, but also against the medium and small companies, especially if the data available to the SRS indicates a high risk of tax evasion in a specific sector with a high risk of a shadow economy. FICIL emphasises that all companies that act illegally and break the law by avoiding tax payments should be targeted and punished by the SRS. The total damage caused to the Latvian economy and fair competition from the shadow economy generated by a large number of small businesses may even be several times greater than the damage caused by a few larger companies. A chance to change the operating models of small dishonest businesses, by letting them know the high risk of being caught and severely punished, is more realistic, than changing the model that has been practiced for a long time. At the same time, it can be assumed that the resources devoted to the inspections of smaller enterprises would be significantly less than those devoted to the inspections of large enterprises. A more standardised approach to the control of smaller companies, which would contribute to the effectiveness of the respective checks and audits is also possible and should be considered, for instance, by greatly increasing the fines for non-submission of the annual report or the consolidated annual report and introducing stricter penalties for non-submission, such as exclusion from certain registers or liquidation, if after multiple violations no appropriate response follows¹⁶.

Changing public perception on decisions taken and reasons for punishment or non-punishment

During the last few years, unfortunately, it has not been possible to change the public’s negative view on the feeling of impunity that exists among the perpetrators of the crimes in question.

¹⁴ Direct evidence is necessary to prove a person’s guilt in committing the criminal offences as set out in the Criminal Law.

¹⁵ FICIL does not dispute that the presumption of innocence is the cornerstone of the criminal justice system. However, the use of indirect evidence to prove a person’s guilt, in general, does not violate this principle.

¹⁶ <https://likumi.lv/ta/en/en/id/324249-accounting-law> 42 Section.

Latvia must ensure that in situations where “headline-making” criminal proceedings are delayed for objective reasons, accused persons are acquitted or criminal cases are terminated, the public is provided with comprehensible information of the grounds and reasons for the respective legal outcome. Otherwise, such settlements could create a sense of impunity for perpetrators of illegal activities and for society. This could, accordingly, undermine any efforts to improve the situation in the prevention of financial and economic crime. Firstly, **there is a need for regularly updated and publicly available information on the objectives set by tax crime investigators and the prosecution, the steps to be taken and key performance indicators (KPIs).** Secondly, **there is a need to provide the public with complete and comprehensible information in situations where investigations in publicly known cases are terminated.**

Taking a whole of society approach to eliminate the shadow economy in today's culture

One of the main root causes of the shadow economy is a cultural element, i.e., society accepting that some transactions take place in cash and that it is acceptable not to declare part of the income. Latvia has more than 40,000 child maintenance debtors whose debt to the state exceeds EUR 527 million¹⁷ and is on an upward trend, while the total debt exceeds EUR 870 million as at the start of 2023¹⁸. Analysis of the aforesaid information, including studies of social profiles, employment, the actual material situation of the persons involved, together with information already at the disposal of the SRS, may make a significant contribution towards reducing the shadow economy and preventing its root cause. **It is necessary to create an environment where the sense of impunity is reduced and the option of hiding while being part of the shadow economy is made extremely difficult.**

Submission of personal income tax returns

In addition, FICIL believes that the mandatory submission of personal income tax returns should be introduced to reduce the level of tax evasion, and the tax returns should utilise behavioural techniques that other countries have tested and found effective¹⁹. For example, the Estonian tax authority has launched Tax Behaviour Ratings, Spain and the UK are using behavioural insights²⁰. For

example, even if the tax return is based purely on data available to the SRS, the taxpayer must actively confirm that he/she has declared all the income received and is aware that there is an administrative or criminal penalty for non-declaration/hiding income with the purpose of intentionally avoiding paying taxes. Another recommendation that FICIL has made previously would be a precondition for this - **simplification of the tax returns and tax system for individuals and traders and improving the quality of automatically pre-populated information and automatic quality controls to improve efficiency and limit the need for manual tax return reviews.**

Increasing the transparency of SRS by publishing their risk criteria, while continuing to increase the capacity of SRS and the obligation to adhere to the specific KPIs on activities and results that are benchmarked against the tax administrations of other countries to identify the progress in combatting the shadow economy.

Digitalisation of processes and controls is a must in improving efficiency of the tax administration²¹. Currently the SRS employs risk control mechanisms to identify the tax risks and taxpayers (both companies and individuals) which need to be investigated in more detail. However, by keeping such risk markers confidential, the tax authorities have to manually send some enquiries as an initial process and then review each case individually, which is a time and resource intensive process. **The SRS's purpose should be not only to “catch” tax evaders, but to increase tax revenues without the need to intervene, and this would be achieved through publishing the obvious indicators that trigger tax risks and tax enquiries, in order to facilitate the self-regulation of more taxpayers. FICIL would like to reiterate its previous recommendation that the SRS should publicly disclose its risk assessment criteria or measures for indirectly identifying situations where taxes are underpaid and contributing to the shadow economy, to facilitate the self-regulation of taxpayers without the need for intervention by the tax authorities and the spending of state resources for individual reviews.**

A possible next step for the utilisation of the data analytics-based risk identification could be the introduction of a public risk “marker” list that indirectly indicates towards operations in the shadow economy.

17 Plāno paplašināt ierobežojumus uzturlīdzekļu parādniekiem - LV portāls (lvportals.lv) <https://www.ugf.gov.lv/lv/jaunums/tieslietu-ministre-uzturlidzeklu-paradniekiem-janosaka-vel-stingraki-ierobezojumi>

18 Information given to FICIL by State Revenue Service during meeting on 6th of July, 2023.

19 e.g., Innovative Ways to Increase Tax Compliance | NBER (<https://www.nber.org/digest/aug14/innovative-ways-increase-tax-compliance>)

20 https://www.oecd-ilibrary.org/sites/1e797131-en/1/3/4/index.html?itemId=/content/publication/1e797131-en&csp_=38baa8bc2bc68a4be5b070db809f1650&itemIGO=oecd&itemContentType=book

21 <https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/tax-administration-3-0-the-digital-transformation-of-tax-administration.pdf>

Where the set markers are met, the tax authorities would have the right to investigate the taxpayer and make a tax assessment based on indirect proof and income level indications. For example, a combination of low salaries and high profits that are then regularly paid out in dividends (relative to industry trends) would indicate a high probability of the shareholder paying “envelope salaries” from the received dividends. Or, for example, hairdressers using a large amount of water, more than is needed for the average number of clients, but the declared revenues are low and while at the same time reporting low level of profits and tax payments. In addition, data showing turnover per employee that is lower than the respective industry level and low salaries might indicate undeclared income and envelope salaries.

Another recommendation FICIL has made previously is to increase the transparency, the effectiveness and efficiency of the SRS in fighting the shadow economy. It must introduce specific KPIs on the activities carried out and the results achieved so that they can be measured over the years to show progress, as well as being benchmarked against the tax administrations of other countries²².

✓ In cooperation with the private sector, improve regulation to combat the shadow economy in the manufacturing, construction and building materials sector, specifically, in the area of residential housing.

It is positive to see that the construction sector has been taken as a priority sector to focus on when reducing shadow economy levels, as it continues to be a leader in this aspect. Even though steps are being taken in the right direction with a Ministry-overseen working group created to look for ways to reduce the shadow economy in the construction sector, FICIL sees there is still a lack of measures that address the problem of the shadow economy in the manufacturing, construction and building materials sector, specifically, in the area of residential housing.

Most of the construction of residential housing (detached, semi-detached, terraced houses) takes place without the involvement of credit institutions²³ and does not assess the origin of the funding involved or whether a private individual has sufficient legally attained financial resources to complete construction.

²² https://www.ficil.lv/wp-content/uploads/2022/09/FICIL_PP_Shadow_Economy_EN_2022.pdf

²³ In the case of the involvement of credit institutions, they shall assess both the sufficiency of the financial resources necessary for the implementation of the construction, their origin and the reasonableness of the construction costs.



Both the receipt of a construction permit and commissioning of the building should be linked to the ability of the owner to prove that it has been constructed legally. Even in situations where the construction of residential housing is carried out by legal persons with an intention to sell the properties to new owners, the effectiveness of the legal framework and its application with regard to ensuring the legality of the construction process and liability for infringements, both in relation to the lawful use of building materials and the payment of the applicable taxes, must be assessed.

Also, improvements are still needed in cooperation and information exchange between the SRS and State Environmental Service of the Republic of Latvia (VVD). For example, there are still situations where manufacturers of building materials unethically use permits to carry out polluting activities, i.e., apply for and obtain permits of a category that is not in conformity with their commercial activities, so that there is no need to ensure strict environmental protection requirements appropriate to the actual activity. VVD formally checks compliance with the category applied for, rather than using the company's financial information that demonstrates the need to comply with stricter requirements. Cases of commercial activity without any permits to carry out polluting activities have also been observed.

/// Create a policy that favours and fosters more honest business practices by creating benefits to the good taxpaying businesses, thus increasing business motivation to leave the grey economy.

The Ministry of Finance and SRS should rethink the range of services they could offer to businesses that are rated "good" and "high" – either as "A" or "B". This could be or may be adopted from membership of the legislative or methodological guidance working group (as, for example, set out in the Statutes on the SRS Strategic Development Council). Similarly, it is important to consider the viewpoint of employees, as it would be desirable for employees to feel that the employer is a good cooperation partner for the SRS, and for example, for such companies the well-being measures for their employees, which are considered to be of a commercial nature in the understanding of Enterprise Income Tax (EIN), could be expanded, and therefore, do not constitute the base subject to EIN taxation.

24 Advance Pricing Agreement.

25 Additional consideration should also be given to recognising the status of start-ups if they have not yet had the opportunity to move to category A.

FICIL would recommend considering additional benefits for such companies:

- ///** Reductions in fees for services provided by the SRS in the fields of customs, excise, and other taxes, such as exemption from fees for entering into an APA²⁴ agreement.
- ///** No requirement by SRS for documents issued by foreign tax authorities, but instead SRS themselves ensure communication with foreign tax authorities to obtain the necessary information. SRS could prepare such necessary confirmations in half the time.
- ///** Continue swift tax refunds for the good taxpayers.
- ///** Additional "points" or easier procedures when applying to and being evaluated for public procurement process tenders²⁵.
- ///** Urge a reduction in late fees for category A companies that voluntarily correct errors on their own initiative.
- ///** Ensure that such companies are treated equally by all SRS supervisory units.
- ///** Provide such companies with easy access to SRS seminars and hold special seminars for category A companies (free of charge).
- /// Centralise and encourage closer cooperation in public procurement processes among public sector officials from different institutions.**

The proficiency of public procurement organisers (officials) needs to be enhanced. Despite the various tools and options available to organise public procurement procedures, they are not being utilised efficiently. While significant improvements have been made in expanding dynamic procurement systems on pre-defined deliveries and pre-qualified providers, the use and case studies of softer tools with quality enhancing benefits remain hard to find.

FICIL maintains the position that cooperation among public authorities, unless prescribed with detailed rules of conduct remains weak and this holds true in the procurement area. Every public official involved in organising procurements must act according to law but cannot be expected to act as an expert in each area of procurement.

While FICIL understands the importance of following the legal procedures, the importance of economic and business understanding cannot be overlooked, as it plays a crucial role in ensuring the best economic outcome. While participating in recurring procurements, officials improve their understanding of specific or complex procurements, therefore, close coordination with experienced public procurement professionals is essential.

The public authorities should be encouraged to assist and seek assistance from each other in planning, setting up and monitoring the performance of complex procurements. Cooperation should start with, but not be restricted to authorities within the same area of public policy or chain of reporting. The expected cooperation does not require more state resources, although reallocation of resources may impact on the individual budgets of authorities, savings to the overall state budget would outweigh it significantly.

Implement necessary changes and adopt practices to foster a wider framework for evaluating public tenders, to create a system that does not predominantly consider price as the only qualifying factor.

Price affects quality. Quality can be qualifying criteria in public procurements, in many instances quality or process of deliveries can have multiple aspects achieving different goals for public authorities. Whether it is risk mitigation (e.g., supply chain) or achievement of green policies, non-price criteria potentially allow for better value in procurements.

Selection of the most economically advantageous bid of a tender is an important tool for achieving the aforementioned objective. However, it can only be efficient and lead to the desired solution on condition that the contracting authority is aware of the actual public needs, real market situation and the need to accurately balance the potential price with quality. In Latvia, price alone, as an awarding criterion, still remains predominant in public tenders. The cheapest bid should not be the only determining factor, especially, when it is achieved at the expense of the employee salaries, social guarantees, or tax payments of the bidder.

Establish a more meaningful and less formalised reliability assessment system for bidders to address the root cause of the issues. To facilitate this, "self-cleaning" measures should be overhauled to address the root causes of infringements.

In 2023, an important deterrence tool has entered into force in public procurements in Latvia, where bidders can be excluded from tendering, primarily, where they have breached any of a set of rules²⁶. Since the ability to exclude has been expanded, this may affect more potential bidders and reduce the number of bids received. Keeping in mind these consequences and the goal to be achieved through procurement process, it poses additional challenges for procurements.

The assessment of business reliability demands making predictions of the future conduct of a different entity which is already a challenging practice. For example, the most recent cartel²⁷ findings in Latvia concern markets which are heavily dependent on public awards. Thus, assessment of credibility and its process may affect the continuity of business for local and foreign businesses in Latvia. Where reliability is demanded from businesses, the state should follow suit.

So far, the "self-cleaning" measures have been formal, which are unlikely to achieve the intended results. Where systematic infringements have been found, systematic change should be a requirement for ensuring fair competition. Understanding what drives the companies to breach the law will allow authorities to identify what measures must be taken to counter it. Making such an assessment requires a tailored approach considering the market, infringements, the role of the state, the rights of defence and public interest.

Evaluate and address inefficiencies that may arise from state representatives overseeing multiple state-owned companies. Introduce organisational or financial consolidation to create operational synergies.

While significant improvements have taken place in recent years to promote best practices and international recommendations in the corporate governance of state-owned companies and their role in commercial activities, further steps can be taken to achieve their optimal management and benefit to the wider interests of the economy. In addition to purely profit-making goals, state-owned companies are also used as tools to achieve policy goals where market failure exists. While the policy goals for various ministries may be different, they must be aligned and provide a consistent list of goals for the company to integrate in their business and execute in its operations, especially where the state ownership is represented by more than one representative or has to oversee multiple entities.

²⁶ https://www.iub.gov.lv/lv/jaunums/skaidrojumi-regulejumam-01012023?utm_source=https%3A%2F%2Fwww.google.com%2F

²⁷ Road construction cartel, construction cartel and public transport cartel.

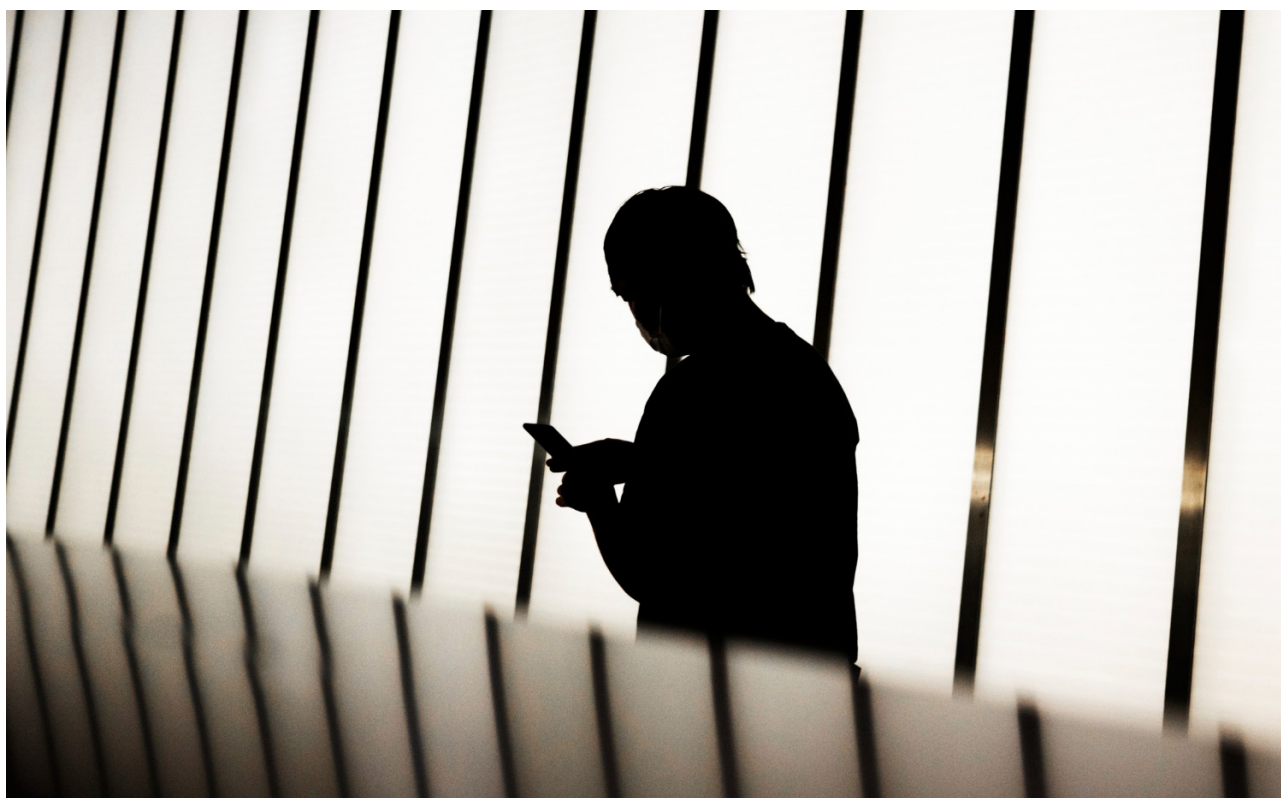
Implement transparent procedures for the selection of supervisory board members, ensuring they have the necessary skills and resources to independently supervise company management and related affairs while minimising political influence in guiding company management.

State ownership at its essence must be represented in a consistent manner. Where there is no single representative of the state, any alignment of positions, opinions or views must be resolved prior to making decisions on the appointment of company management and voting in shareholders' meetings. Where companies have supervisory boards, their members must be selected in transparent procedures and ensure they have the necessary skills and resources to independently supervise the actions of management and company affairs. While acting in the interests of the shareholders, supervisory boards must also provide guidance free from any signs of political impact to the management of the company.

On the other hand, state representatives may be required to oversee multiple state-owned companies, which may create inefficiencies in exercising ownership rights and the individual performance of a company. Consolidation, whether from an organisational or financial perspective may create synergies in company operations. This may further allow for better access to public capital markets which are still undeveloped in Latvia.

To improve corporate governance, transparency, and accountability, enable state and municipality-owned companies to access public capital markets.

Contrary to a somewhat populist myth, state and municipality-owned companies can leverage public capital markets to their advantage without privatisation. Usually in capital markets only a limited portion of company shares (up to 20%) is in free float, thus the state would retain majority ownership and control over the company's decision-making. Tapping capital markets bring several benefits, including improved corporate governance, greater transparency, and enhanced accountability to investors and stakeholders. In addition, allowing citizens to purchase shares in state-owned enterprises creates a sense of ownership and participation in the nation's economic progress. It fosters a stronger connection between the public and these companies, encouraging broader societal involvement and also support. Additionally, it allows the introduction of employee share option programs, thus aligning the interests of the workforce with the company's success, boosting motivation and productivity. Through engagement into public capital markets, state-owned companies can strengthen their financial position, attract institutional investors like pension funds, and diversify their shareholder base.





FOREIGN INVESTORS' COUNCIL IN LATVIA POSITION PAPER ON LEVEL PLAYING FIELD

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