Opportunities for improving municipal action, institutional cooperation and implementation of public investment projects to promote businesses in local and regional governments

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Audit report

“Opportunities for improving municipal action, institutional cooperation and implementation of public investment projects to promote businesses in local and regional governments”
4 November 2024
Performance audit “Have municipal activities and investments contributed to business development?
The audit was performed based on audit schedule No 2.4.1-8/2023 and its amendments of the Fifth Audit Department of the State Audit Office of Latvia of 31 January 2023.
Technical clarifications made to the report by decision No LEMGROZ–68/2024 of 25 November 2024.
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Dear Readers,

We have completed the assessment of a multidimensional area of business development and investment attraction in local and regional governments. Although success stories in business are a combination of several complex circumstances and factors, business development and investment attraction are also influenced by the actions, cooperation, and decisions made of state administration institutions and opportunities used correctly.

The European Union funding available for the 2014–2020 programming period was one of the possibilities. Local and regional governments have implemented 229 investment projects worth 490 million euros while using this funding source and national co-financing.

The European Commission drew the special attention of the EU Member States to the effectiveness of public investments by emphasising that it was the responsibility of each EU Member State. However, in the audit we concluded that EU and national public investments did not always achieve the set goals and solve the most pressing business environment problems in local and regional governments. In addition, the results achieved in the implemented projects do not always contribute to greater private co-investments, create new jobs and tax revenues in municipal budgets.

During the audit, we became convinced that not all local and regional governments were ready to put investment projects on the table that would really promote business development. The most significant part of the available funding was used to compensate for the budget deficit of local and regional governments for road repairs. Yes, we agree with the relevance of such a need but one cannot deny that the funding has been used more for other needs than to create a “new space” for the promotion of business that would really create new jobs for residents, opportunities for entrepreneurs and a contribution to the national economy.

We analysed the possible causes during the audit and concluded that there was room for improvement. Firstly, local and regional governments can do their “homework” much better by identifying the factors hindering business development and investment attraction. Secondly, coordination among local and regional governments, the Ministry of Smart Administration and Regional Development (MSARD), programming regions, the Latvian Investment and Development Agency (LIDA), line ministries, their subordinate institutions and state-owned enterprises needs to be improved significantly.

More effective cooperation, coordination and elimination of “inter-institutional barriers” would be a significant step forward in establishing clear and understandable “rules of the game” in the implementation of investment projects and the use of available funding. It would allow the funding available for business development to be spent more meaningfully and efficiently. Improving the monitoring indicators of implemented projects and their evaluation system is equally important so that the investments made provide the greatest possible return, thereby increasing revenues in municipal budgets.

In our opinion, the audit findings and recommendations mentioned in this report will serve as a useful resource for policymakers, stakeholders and society as a whole, as well as promote a constructive dialogue on further steps to improve the business environment in Latvia.

Thank you for the contribution and cooperation of the specialists of the Ministry of Smart Administration and Regional Development, the Latvian Investment and Development Agency, the Central Finance and Contracting Agency (CFCA), the programming regions and the audited local and regional governments which participated in this audit.

Respectfully
Mr Oskars Erdmanis
Department Director

Summary

Main conclusions

While using EU funding instruments as a source of finance, local and regional governments implement investment projects, which are public sector intervention measures to facilitate businesses. However, the audit concluded that EU and national public investments in 229 projects in the amount of 489,839,170 euros did not always "hit the target" and address the most pressing business environment problems directly in local and regional governments and the results achieved within the framework of the implemented project did not always promote investment attraction. Cooperation and coordination among the audited local and regional governments and other institutions (MSARD, programming regions, LIDA, line ministries, their subordinate institutions and state-owned enterprises) for improving the business environment in local and regional governments and attracting private investment, including foreign, investment, also needs to be improved.

In 14 projects (road infrastructure was built in 10 projects and rental infrastructure was built in 4 projects) out of the 34 projects analysed, one has detected that the output indicators "Number of newly created jobs" and "Non-financial investments in intangible assets and fixed assets of economic operators that benefited from infrastructure investments made within the project" were confirmed as achieved before a project application was submitted to the CFCA and also during the project implementation.

Although the MSARD included a requirement in laws and regulations, which the State Audit Office of Latvia considers to be favourable, for the recognition of the output indicators of projects implemented by local and regional governments as approved in advance, namely, in the two-year period before the submission of project applications, with the aim of expanding the possibility for local and regional governments to apply for EU co-financing for projects implemented by local and regional governments, it did not create a clear control environment for assessing the intervention logic in these projects in these cases. Similar risks can be seen in projects in which the output indicators were achieved during the project implementation. It raises concerns for the State Audit Office of Latvia as to whether the projects implemented in the 2014–2020 programming period for EU funds in the amount of 98,675,843 euros or 20% of the total funding have had the highest possible efficiency.

The State Audit Office of Latvia considers that the approved output indicators are not directly causally related to the activities carried out in a project in such cases. The audit also found that the CFCA, as the supervisor of the output indicators of investment projects, has not obtained sufficient assurances about the causal relationship between the output indicators and the activities implemented in the project. Thus, obtaining reasonable assurance is impossible that they truly create the social and economic benefit of the project "Increase in personal income tax revenue" for local and regional governments.

The best practice indicates that regional development policy is effective only if the benefits

offered by the support programme exceed the programme costs[12]. Although several social and economic benefits are expected as a result of public investments, the State Audit Office of Latvia draws attention to the fact that the beneficiaries of the financing, id est, local and regional governments, have undertaken and are implementing the projects within their own budgets, as well as by attracting borrowed capital. Therefore, the State Audit Office of Latvia performed calculations as part of the audit to determine the impact of public investments on the budgets of the audited local and regional governments, with the aim of showing what the situation was in 2024 and draw attention of the audited local and regional governments to the fact that there is a credible probability of a negative balance during the repayment of the loans received if the local and regional governments do not take risk-mitigating measures. According to the estimates of the State Audit Office of Latvia based on the data available at the time of the audit, the audited local and regional governments develop a negative balance of at least 1,019,904 euros annually after the implementation of a project (project-related expenses exceed revenues), which can reach up to 20,513,466 euros during the repayment of the loans received, which indicates that their return is low. Since in none of the implemented projects, local and regional governments have indicated businesses as cooperation partners, in fact only local and regional governments are fully responsible for achieving the output indicators of businesses planned in their projects. Consequently, the negative financial impact from investment projects may increase significantly, as the audit identified projects that could be subject to financial correction potentially, namely, local and regional government shall have to repay the co-financing granted by the EU if the project output indicators are not achieved by 2028.

Business environment and investment attraction in local and regional governments

Responsibility for the implementation of projects under SSO 3.3.1 and SSO 5.6.2 that have not promoted businesses sufficiently and have not also contributed to attracting investment in local and regional governments lies, in fact, with all parties involved: local and regional governments, programming regions, the Regional Development Coordination Council, the MSARD and the CFCA. It is confirmed by the inconsistencies identified in the audit in the processes of development planning, financial management, project management, as well as supervision over the implementation of projects.

Although various factors influence business development that may not be directly under the influence of local and regional governments, a local or regional government can affect the business environment both positively and negatively through its actions in its administrative territory.

Facilitating economic activity in their administrative territories is one of the autonomous functions of local and regional governments. The role of local and regional governments in promoting business development and ensuring economic growth is diverse, covering infrastructure development, improving the regulatory environment, and financial support programs. The range of business support instruments offered by local and regional governments is broad (grants, real estate tax discounts, rental discounts, etc.) but local and regional governments spend in practice less funding for such activities compared to investments from

EU funds.

Although these elements of municipal activities are important, they are less significant in ensuring long-term economic development compared to strategically planned and carefully implemented investment projects because:

- Albeit improvements in the regulatory environment such as reducing red tape and faster permitting are important in promoting entrepreneurship and create favourable conditions, they are not sufficient to ensure significant economic growth compared to the implementation of investment projects;
- Financial support, such as grants and tax breaks, are important for the establishment of new businesses and the expansion of existing ones but they are often limited and dependent on the budget capabilities of local and regional governments; this support is more of a short-term stimulus while investment projects provide the basis for long-term infrastructure and economic growth.

The actions of local and regional governments assessed in the audit lead to the conclusion that local and regional governments should focus on those activities that have the greatest impact on sustainable economic development more and treat them with greater responsibility. In this context, investment projects stand out as the most essential element by ensuring long-term economic impact and allowing to attract private investments.

The largest investments in the field of business promotion were made by attracting EU co-financing and state loans. In the 2014–2020 programming period of EU funds, local and regional governments had access to financial resources from several specific support objectives for the first time within the framework of priority axis “Competitiveness of small and medium-sized enterprises” including SSO 3.3.1 “Increase the volume of private investment in the regions, making investments in business development in accordance with the economic specialization of the territories determined in the municipal development programs and based on the needs of local entrepreneurs” and SSO 5.6.2 “Revitalization of territories by regenerating degraded territories in accordance with the integrated development programs of local and regional governments”. During the 2014–2020 programming period of the EU funds, local and regional governments have implemented 229 investment projects, investing 489,839,170 euros in total including 294,510,457 euros of EU co-financing and 195,628,713 euros of national funding.

The focus of local and regional governments on public investment projects is justified to develop the local economy. Therefore, careful development of strategies and identification of needs are essential to ensure the effectiveness and sustainability of these projects without creating an excessive burden on a municipal budget. Local and regional governments should focus on developing projects that are able to attract private investment, thereby reducing the need to attract public funding.

When using EU funding instruments as financial sources, local and regional governments implement projects that are public sector interventions to promote businesses. These measures (projects) must have an intervention logic, that is, a link between the needs and objectives assessed by a local or regional government (which are its problems and needs in business), investments (EU and national co-financing of projects), outputs (built public infrastructure for business development) and results (beneficiaries – enterprises, jobs created and non-financial investments).

In the 2014–2020 programming period, the European Commission drew special attention of the EU Member States to the assessment of the effectiveness of public investments, which was the responsibility of each EU Member State. Consequently, the State Audit Office of Latvia paid special attention in its audit to the assessment of the intervention logic, that is, the linking of public investments made by local and regional governments and implemented projects with the problems to be solved in business identified in development planning documents, as well as the achieved return on investment (ROI) indicators, including the achieved impact on the municipal budget.

In the opinion of the State Audit Office of Latvia, the main reasons for unsuccessfully implemented projects (for example, unleased production facilities) are shortcomings in strategic planning and financial management, which have not allowed decisions to be made not about the desired, but about the impartially possible business environment. For example, the majority of implemented investment projects have low ROI indicators[13], that is, the amount of economic benefits for each euro invested by taxpayers is below two euros in 54% of cases out of the 34 projects included in the audit sample. In their turn, inconsistencies in the development planning process of the audited local and regional governments, an overly broad interpretation and application of the “degraded territory status” in practice, and unsystematic work with degraded territories in local and regional governments did not ensure the implementation of projects as a priority in actually degraded territories.

The process of elaborating development planning documents in the audited local and regional governments does not always provide a comprehensive analysis of the situation, identification of problem issues in business and investment to offer the most effective solutions for their elimination. For example, information provided by both the Latgale Programming Region and the Daugavpils Business Incubator shows that one of the main problems of the Daugavpils City Municipality in attracting investors and developing businesses[14] is the lack of suitable buildings and premises but only one of the projects implemented by the municipality includes the construction of a new production building while the other projects involve the reconstruction of roads and the creation of parking lots. The Action and Investment Plan of the Daugavpils City Development Program for 2014–2020 identifies large, degraded territories with infrastructure that does not meet modern requirements and a large number of potentially polluted abandoned industrial facilities and buildings whose owners are unable or not motivated to invest funds in the renovation of these facilities as one of the economic challenges and a significant problem. When planning to develop projects within the framework of SSO 5.6.2, the Municipality conducted surveys of enterprises which identified that the prospective development of business required not only the improvement of public infrastructure but also the demolition of degraded buildings and the reconstruction of existing buildings[15].

Consequently, the monitoring mechanism implemented by local and regional governments for the achievement of the goals set in development planning documents becomes a formal fulfillment of statutory requirements, without conducting a causal analysis of the planned and actual impact of the implemented activities. When implementing large infrastructure projects that attracted EU funds, the impact of the intervention is also not assessed to a sufficient extent, namely, only those output indicators are assessed that need to be assessed when reporting to the cooperation institution, the CFCA.

The projects included in the development programmes and investment plans do not reflect all the priority needs of the audited local and regional governments, as it is often impossible to identify the link of a project with a specific problem or need identified in the development programme that the implemented project will address. If EU co-financing is available, investment plans are amended and projects are included therein that are not identifiable clearly in the development programmes, and after amendments are made to the investment plans, the projects are submitted to the CFCA. As a result, the intervention measures determined by the audited local and regional governments are fragmented and often unrelated to the most important priorities, subordinate to available external funding, even changing the territorial planning for degraded areas if necessary. When assessing the projects implemented by the audited local and regional governments under SSO 5.6.2 that provided co-financing for the revitalization of degraded territories, it was found that in 14 projects out of 19 projects, or 74%, the projects were implemented in territories indicated as degraded in the investment plan of the development program (including amendments) but not in other documents that determined the purpose of land use.

The audit has detected one case where the Valka Regional Government presented agricultural land as a "degraded territory" to receive EU co-financing for the implementation of the project contrary to the provisions of the regulation[16]. Thus, the project was approved for receiving EU co-financing in the amount of 744,480 euros under SSO 5.6.2 unreasonably (total project costs constituted 1,337,496 euros).

The role of LIDA and programming regions in business development and investment attraction in local and regional governments

Insufficient cooperation among programming regions, the LIDA and local and regional governments hinders the attraction of private investment, including foreign investment, to the regions. No agreement has been reached at the regional level, and the development planning documents do not specify the economic specialization or profiling of regions and local and regional governments in business areas. It would allow using the strengths of a local or regional government in its economic growth by planning and channelling available funding accordingly, thus reducing "negative competition" for investments and labour in regions and local and regional governments.

In fact, almost all audited local and regional governments implement projects for the development of any sector, as long as attracting EU co-financing is possible while assessing market failures in the region, the strengths and weaknesses of the local or regional government, the needs of businesses, the interest of foreign investors and the conditions for starting/transferring a business to Latvia and other important aspects in the decision-making process insufficiently.

The role of programming regions (except for the Latgale Programming Region) in business and investment attraction is formal and does not provide much added value to local and regional governments in promoting businesses and attracting investment. Only the Latgale Programming Region is involved actively in attracting investment in the region both by providing advisory assistance and by organising foreign trips and addressing potential investors. The work of the programming region is also characterized by real success stories about investors entering local and regional governments. Local and regional governments within the Latgale Programming Region also evaluate cooperation with the programming region positively. For example, the programming region attracted a foreign company in Balvi in cooperation with the LIDA in 2022 whose sewing factory employs around 200 employees.

However, the State Audit Office has concluded that the cooperation of the LIDA with local and regional governments could be improved to facilitate a more active inflow of foreign investment into the national economy. Already in 2010, the LIDA began to introduce and implement an investment attraction and servicing tool, the POLARIS methodology, according to which one planned to increase the activity of local and regional governments in attracting foreign investment. Although it provides for several activities, the possibility of prioritising nationally significant investment projects is recognized as major. To ensure this process, a system was envisaged in which all involved stakeholders (line ministries, state-owned enterprises and others) would agree on the activities and those responsible to ensure a positive outcome of an investment project centrally. The audit findings indicate that the basic principles of the system “remained on paper”. The audit identified one potentially large investment project, which would probably be implemented as a result of the effective application of POLARIS methodology process. As a result, the state did not receive approximately 5-10 million euros in investments.

In general, the level of awareness of local and regional governments about the services provided by LIDA is insufficient, especially about the potential opportunities of these services. For instance, the awareness of local and regional governments about the state information platform for business development created by LIDA, *business.gov.lv*, is insufficient. The platform offers the opportunity to place information about potential investment sites in each local and regional government creating an investment map. Thus, information is provided to potential investors in one place. Insufficient awareness of local and regional governments about such an opportunity creates both additional costs for them to maintain information on their websites and creates an additional administrative burden because local and regional governments prepare information for a potential investor upon each request from the LIDA. In the opinion of the State Audit Office of Latvia, such fragmentation of information sources does not contribute to the speed and completeness of information exchange for investors who obtain information about potential investment sites in Latvia independently.

Investment project implementation process and results

In this audit, the State Audit Office of Latvia has assessed how the projects implemented under SSO 3.3.1 and SSO 5.6.2 have promoted business development, which, after the implementation of the project, is to be measured by two output indicators set by the MSARD, that is, “a number of newly created jobs” and “non-financial investments in their own intangible investments and fixed assets of businesses that have benefited from the investments in infrastructure made within the framework of the project”.

Between 2016 and 2023, there were 489,839,170 euros spent for 229 investment projects aimed at reducing inequality among regions and promoting business and investment attraction environment in Latvia. However, the monitoring system for project output indicators under SSO 3.3.1 and SSO 5.6.2 established by the MSARD and determined by the Cabinet Regulation allowed the selection and implementation of projects whose output indicators had been achieved before a project application was submitted. The investment projects of the audited local and regional governments are often not directly related to a problem identified in the development program and have been included in the investment plans in a relatively short period of time before a project application was submitted to the CFCA, for example, even on the same day the project was submitted to the CFCA. In most cases, it did not allow economic operators to decide on investments in business two years before a project was launched based directly on the intention of audited local and regional governments to implement investment projects. At the same time, the output indicators of some projects have been approved in the period before the end date of project implementation. The auditors consider that the intervention logic between the investments made by local and regional governments and the output indicators achieved by businesses before these investments were made is questionable in most cases thus raising concerns about whether the projects implemented in the 2014-2020 programming period for EU funds in the amount of 98,675,843 euros or 20% of the total funding have the highest potential efficiency.

The calculations of the State Audit Office of Latvia show that ROI rates are low in most cases. Although the purpose of public investments is not to achieve the maximum value of return (profitability), public investment must at least reach the so-called zero point, that is, the benefit must cover the resources used. When making a decision on the implementation of an investment project, benefit-cost ratio (BCR) is determined for the assessment of ROI rates in practice. If a value of the indicator is 1, it means that investment costs are equal to benefits.

The return on public investments depends on a specific project and its targets. However, for investments to be effective, they must have a significant economic and social impact. When assessing the projects implemented under SSO 5.6.2 during the audit, it was taken into account that following the statutory framework, SSO 5.6.2 projects must provide for greater effectiveness in achieving output indicators so that the values of the output indicators specified in the operational programme whose equivalent value in monetary terms in relation to ERDF funding is 2:1, are generally met. Given that the targets of SSO 3.3.1 and SSO 5.6.2 are the promotion of business, the values of output indicators, whose equivalent value in monetary terms in relation to ERDF funding was 2:1, were assessed as the best practice, such a value (2:1) was applied to the total ROI of public investment in the audit.

Under SSO 3.3.1 and SSO 5.6.2, the performance indicators are defined as newly created jobs and non-financial investments which characterise the degree of achievement of the project objective. When approving the achieved output indicators of projects, the CFCA does not carry out their further monitoring. Hence, the State Audit Office of Latvia assessed in the audit what the return on projects was at the moment of achieving the project objective (output indicators).

The financial analysis of the EU co-financed investment projects of the audited local and regional governments conducted by the State Audit Office shows that the output indicators of public investments have not been achieved or have been achieved partially in 61% of cases, thus determining the return on investments made before the output indicators are fully achieved is impossible. The audit found that the economic benefit obtained for each euro invested was below two euros in 54% of cases (the lowest ROI was 0.54 euros for 1 euro of investment). In their turn, the costs of newly created jobs range from 6,802 euros to 162,642 euros. The Cabinet Regulation governing the co-financing of projects under SSO 3.3.1 and SSO 5.6.2 provides that no more than 41,000 euros of ERDF co-financing on average is invested in the creation of one new job in private sector within the framework of the allocated co-financing. When applying this criterion to the total amount of public investment invested in the project, one concluded that values above 41,000 euros were found in 24% of the projects included in the audit scope.

The data obtained show that the public funding actually used has not achieved higher efficiency by creating more newly created jobs. The local and regional governments had to achieve output indicators by 31 December 2023, yet the final reporting deadline has been extended to 31 December 2028[17].

Although several social and economic benefits are expected as a result of public investments, the State Audit Office of Latvia draws attention to the fact that the beneficiaries of the financing, namely, local and regional governments, have assumed project risks and are implementing the projects within their own budgets, as well as by attracting borrowed capital. Therefore, the State Audit Office performed calculations as part of the audit to determine the impact of public investments on the budgets of the audited local and regional governments with the aim of demonstrating what the situation was in 2024 and drawing the attention of the audited local and regional governments to the fact that there was a credible probability of a negative balance during the repayment of the loans received if the local and regional governments would not take risk-mitigating measures. According to the State Audit Office estimates based on the data available at the time of the audit, a negative balance is formed annually in the audited local and regional governments (project-related expenses exceed revenues) in the amount of at least 1,019,904 euros after the implementation of the project, which can reach up to 20,513,466 euros during the repayment of the loans received indicating that their return is low.

The State Audit Office of Latvia finds that the process of evaluating project ideas delegated to the Regional Development Coordination Council has not ensured the operation of a control system that mitigates the identified risks. During the selection of projects, road infrastructure projects were prioritised opposite to the specified provisions in the Partnership Agreement. When assessing 101 projects implemented under SSO 3.3.1, the State Audit Office of Latvia detected that the main activities of 85% of projects were related to the reconstruction of roads/streets and related infrastructure (e.g., lighting) but only 11% of projects were related to the construction/reconstruction of buildings (including the associated road infrastructure as well) and 3% of projects were related to the installation of communication infrastructure. Under SSO 5.6.2, local and reginal governments implement the reconstruction of roads/streets mostly where 65% of the implemented projects are of this type while only 32% of project activities include the construction or reconstruction of buildings.

The State Audit Office of Latvia considers that local and regional governments have chosen the simplest solution when shaping an investment portfolio and supporting mostly road/street and related infrastructure projects but, firstly, it is difficult to determine the correlation between such projects and changes in the economic indicators of the beneficiaries, that is, businesses. For example, if a street renovation project is implemented in a city centre where several businesses already operate, it is difficult to achieve a direct causal relationship with such an intervention to the increase in the economic indicators of businesses. Secondly, according to the concluded Partnership Agreement, investments had to be planned to achieve specific goals and be based on an analysis that did not prioritise the development of road infrastructure as a problem to be tackled. Consequently, the risk increases that investments will not ensure the resolution of the identified problems by reducing the effectiveness of the invested public funding.

The selection of project ideas took place in several rounds: three selection rounds for SSO 3.3.1 and four selection rounds for SSO 5.6.2, in which the evaluation of project ideas was ensured by the Regional Development Coordination Council, which did not include representatives of the LIDA. During the idea selection round, the evaluation took place formally by assessing the technical documentation of the projects and not the essence of the projects (their usefulness, risks of violation of state aid conditions, etc.). The analysis of the Council minutes conducted by the State Audit Office of Latvia shows that project ideas were not excluded when identifying risks (including the excessive number of road infrastructure projects, the creation of target-oriented infrastructure, inconsistencies in project output indicators) but it was recommended to clarify the information provided technically before submitting the projects to the CFCA. Projects that have already been identified as having a high level of risk during their planning stage raise concerns that they are being created to support specific, identifiable businesses bypassing the condition of indicating them as cooperation partners do not promote competition and cannot meet either the objectives set for SSO in promoting businesses or the aspects of efficiency.

During the project approval stage, the CFCA accepted almost all projects accepted by the Regional Development Coordination Council in compliance with the applicable statutory framework without taking additional steps to verify previously identified risks and assess the sustainability of projects.

Under SSO 3.3.1 and SSO 5.6.2, a project applicant had to attach a declaration of interest signed by an enterprise to a project application. In the declaration, an enterprise must confirm that the infrastructure planned to be developed within the project is necessary for its further development, that the enterprise will benefit from it and also undertakes to create a certain number of jobs and make a certain amount of investments in its intangible assets and fixed assets. The aforementioned declarations did not create obligations for the enterprise but they were intended to be used as a market research tool to justify that the planned infrastructure really met the needs of businesses and would be necessary for them.

The State Audit Office of Latvia assesses that the preparation of unilateral certificates of enterprises cannot be considered an impartial form of market research. The analysis of the certificates of enterprises attached to project applications carried out by the State Audit Office of Latvia confirms that the audited local and regional governments have not assessed the ability of these businesses to make investments and create new jobs sufficiently. When conducting a financial analysis of the certificates of enterprises, it was found that the certificates had also been signed by entrepreneurs whose analysis of financial indicators indicated risks in the future to undertake the execution of planned output indicators (newly created jobs and non-financial investments).

However, the CFCA has not identified risks in the financial indicators of the enterprises indicated in the certificates during the evaluation process. The project evaluation criteria and their application methodology also do not set specific requirements for checking the information included in the certificates. As a result, there is low activity in the auctions of infrastructure facilities intended for rent, which does not safeguard the rental of the property of the audited local and regional governments, as some sites have no tenants and the audited local and regional governments do not receive rental income to cover the liabilities incurred in the projects.

The aim of the infrastructure built in public investment projects is to promote businesses and attract private investment, while taking into account the requirements set out in laws and regulations to lease sites at the highest potential price to ensure a positive cash flow to the budget. However, the audit concluded that the regulations[18] were not followed when determining the rental fee for property owned by the Valka Regional Government. As a result, it did not generate revenue of at least 983,112.10 euros from 13 November 2019 to 1 October 2024.

Key recommendations

The audit provided 10 recommendations to the audited local and regional governments, the Ministry of Smart Administration and Regional Development and the Latvian Investment and Development Agency:

[1]The local and regional governments shall act to:

- Implement economically sound investment projects which will reduce the problems in the field of business and investment attraction;
- Monitor the established monitoring indicators in the field of businesses and investment attraction systematically including by conducting causal analysis, identifying risks in a timely manner and implementing risk mitigation measures;
- Prevent negative impact on municipal budgets by implementing risk mitigation measures for cash flow management, reducing liquidity risk and increasing revenue, including recovering previously unearned revenue by reviewing the established rents for leased municipal property.

[2] The Latvian Investment and Development Agency shall act to:

- Assume a coordinating role by developing an action plan and framework for promoting cooperation with local and regional governments including by promoting the understanding of local and regional governments about the integration of investment attraction issues into development planning, opportunities for the implementation of large-scale investment projects in accordance with specially prescribed procedures and the centralized use of the state platform for business development *business.gov.lv*.

[3] The Ministry of Smart Administration and Regional Development shall act to:

- Provide a regional inequality reduction monitoring system by developing a unified monitoring indicators for local and regional governments in the field of businesses and investment attraction;
- Reduce “negative competition” among local and regional government by facilitating the exchange of best practices and experience on the advantages and prospective opportunities of economic specialization of local and regional governments aimed at strengthening their economic growth;
- Promote more effective and efficient implementation of investment projects by improving the functioning of the internal control system of EU projects.

References

[12] Opportunities for a local and regional government to influence the development of the local economy, Vidzeme University of Applied Sciences, Institute of Social, Economic and Humanitarian Studies, 2016. Available at: https://www.hespi.lv/sites/default/files/Zinojums_III_dala_Noslegums.pdf (viewed on 4 December 2023).

[13] During the period under review, the business environment was affected by both the COVID-19 pandemic and geopolitical events. Reports from the Central Statistical Office show that there has been almost no growth in any business sector in recent years. (See: https://stat.gov.lv/lv/statistikas-temas/valsts-ekonomika/ikp-istermina/preses-relizes/20753-iekszemes-kopprodukts-2023?themeCode=IK). It should be noted that these events have different impacts (both positive and negative) on businesses representing the sector. The business environment was affected by several factors such as restrictions imposed by the geopolitical situation, rapid inflation, increased cost of financial resources (increased interest rates, etc.) and so on. The above-mentioned factors affected not only the business environment but also the overall state and municipal economy and budgets. Despite the above-mentioned influencing factors, one should note that a risk management system must be introduced in the implementation of any project which allows for timely identification of risks and successful management of them.

The audit goal was focused on the assessment of the planning and implementation process of public investments in local and regional governments while the economic (costs) indicators of specific projects were not included in the audit scope.

[14] The Daugavpils City Development Program 2021–2027 (approved by the Daugavpils City Municipality Decision No 754 of 11 November 2021 (Minutes No 44, Paragraph 32); Summary of the survey among enterprises, p. 11; Minutes of the interview between the State Audit Office of Latvia and the Latgale Programming Region of 18 April 2023.

[15] The Investment and Action Plan 2014–2020 of the Daugavpils City Development Program “My Daugavpils” 2014–2020 (approved by Daugavpils City Council Resolution No 214 of 28 May 2020 on updating the action and investment plans of the Daugavpils City Development Program “My Castle – Daugavpils” 2014–2020, minutes No 23, Paragraph 2), pp. 432, 523–533, 528, 541, 543, resource available: https://www.daugavpils.lv/assets/
upload/manager/AttistibasDepartaments/Dokumenti/RPIP%20aktual%2005_2020_a ktual.pdf (viewed on 14 November 2023).

[16] Article 26.1 of Cabinet Regulation No 645 “Operational Programme “Growth and Employment”, 5.6.2. Specific Support Objective “Revitalization of territories by regenerating degraded territories in accordance with integrated development programmes of local and regional governments” of 10 November 2015.

[17] Amendments of 7 February 2023 to Cabinet Regulation No 645 “Operational Programme “Growth and Employment”, 5.6.2. Specific Support Objective “Revitalization of territories by regenerating degraded territories in accordance with integrated development programmes of local and regional governments” of 10 November 2015 and Cabinet Regulation No 593 of “Regulations on the implementation of Specific Support Objective 3.3.1 “To increase the volume of private investment in the regions by making investments in business development in accordance with the economic specialisation of the territories determined in the development programmes of local and regional governments and based on the needs of local businesses” of 13 October 2015.

[18] Chapter Three, Paragraphs 73, 74, 75, 76 and Chapter Four, Paragraphs 79, 80 and 81 of Cabinet Regulation No 97 “Regulations on the leasing of the property of public entity” of 20 February 2018.