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# THE ROLE OF TRANSIT IN THE ECONOMY OF LATVIA

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*Transit is an important issue in the history of world economy, including the economy of Latvia. Transit makes a significant contribution to the budget of many transit countries, one of which is the Republic of Latvia. These countries do not have significant natural resources and prefer to focus on logistics and infrastructure in order to facilitate the transit process. This article focuses on the role of transit in the economy of Latvia, whose unique geographical position makes the country an effective transport corridor (bridge) in both the west-east and north-south directions. The article presents the results of an opinion poll conducted at Latvian transit enterprises regarding their future development and offers an overview of the main seaports and the Rīga international airport. The author examines the issue of Russia's accession to the World Trade Organization and its impact on the Latvian transit, the prolongation of EU sanctions against Belarus, and the use of Latvian transport infrastructure for handling the non-military cargo traffic to/from Afghanistan. In conclusion, a forecast of possible transit development in Latvia is provided.*

**Key words:** transit, transit corridor, infrastructure, transport, transportation, competition, geographic location, cargo traffic

After the restoration of Latvia's independence the principle vision of the country's development shaped up as the concept of "bridge" between East and West. The evaluation of Latvia's geostrategic advantages and disadvantages demonstrates with sufficient clarity that the country's main strength is its geopolitical situation. An EU state, Latvia is closest to Russia in every way: geographically, linguistically and mentally. Latvia borders on Estonia in the north, Lithuania in the south, Russia in the east, and Belarus in the south-east. This country is located in Northern Europe and is a member of the Schengen Agreement. By January 1, 2012, the population of Latvia

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amounted to 2 217 053 people (compared to 2 424 000 people in 2009) [7]. There are three major ports in Latvia: Riga, Ventspils and Liepāja.

For nine centuries Riga has been the center of international trade and cargo transportation. Riga holds a significant place among other Baltic ports and successfully leaves its competitors behind in the Baltic Sea and the Riga Bay basins— a crossroads of international transport seaways. The intensity of transport services in the Baltic Sea region is constantly growing, and the positions of the Riga Freeport are getting stronger, because it is the most efficient point of cargo transfer that provides for permanent cargo flow between Russia, the CIS and the EU.

The Freeport of Riga is directly connected with the main sources of raw materials, industries, cargo processing and shipment in the CIS and Russia due to a well-developed network of highways and railroads. The geographic location of the Riga Freeport in comparison to neighbouring ports creates more favourable conditions for processing incoming and outgoing cargo. The fact that Latvia borders on Russia and Belarus is an essential prerequisite for developing sustainable, strategic and mutually attractive cooperation. The Riga Freeport is developing as a multi-functional industrial unit, which allows processing any type of cargo except crude oil. The major priority for the port management is the port's overall dynamic growth, and its expansion into adjacent vacant territories.

The Riga Freeport is a member of IAPH, ESPO, BPO and other international professional organizations. Due to such participation, it can effectively offer services of hosted companies and transport infrastructure as an EU port.

The Freeport of Ventspils (Ventspils brīvosta) is located on the Baltic Sea, almost in the center of Ventspils. The Ventspils port runs permanent ferries Ventspils — Nynäshamn (Sweden), Ventspils — Travemünde (Germany) and Lubeck (Germany) — Ventspils — Saint Petersburg (Russia). Since long ago Ventspils has been a major trade corridor between east and west due to its geographical location and ice-free facilities.

The fact that terminals for liquid, bulk loaded and general cargo function all year round in Ventspils, accounts for the importance of this transit Baltic Sea center.

The Free port of Ventspils enjoys the status of a special economic zone, hosting 30 enterprises (mainly stevedores and terminals) eligible to tax benefits. In total, there are twice as many companies in the harbour. Within 10 years Ventspils has succeeded in attracting numerous industrial enterprises — they produce candles and wood pellets, assemble automobile machinery, construct module houses, etc.

Liepāja is the third largest city in Latvia by size, which is conveniently located in terms of cargo transit. This city has always been a transport and commercial center of strategic importance. Its well-developed infrastructure adds to Liepāja's advantages — it is a network of railroads and highways connecting this city to the major industrial regions of Russia and the CIS. It takes only 24 hours to ship the cargo from Liepāja to any port in Northern or Western Europe and then further to some remote parts of the world, America or Asia.

Obvious tax benefits (5 %-rate for income tax for enterprises instead of 15 %, and 80—100 % exempt for property tax) [1; 2] allow the enterprise to

carry out sustainable investment policy thus providing for sustainable development of the territories in possession of businesses. In its turn, the status of a special economic zone creates favorable conditions for processing incoming and outgoing transit cargo from third parties (outside the EU).

Apart from its location, other advantages of Liepāja port are as follows:

- Ice-free facilities all year round;
- A marine port, well-protected with the system of dams and breakwaters;
- The shortest distance from the open sea to piers;
- The shortest distance to the Nordic countries.

In June 2012, the 15<sup>th</sup> annual conference “TransBaltica-2012” was held in Riga. Traditionally, it is supported by the Latvian Association of Transit Business, Latvian Railways, and the Ministry for transport of Latvia and gathers all possible transporters — stevedores, economists, bankers, and lawyers. Such conferences raise the major issues in transit and shipment:

- International tendencies in the Baltic regional market development;
- Development forecasts in transit and shipment infrastructure in united Europe;
- Issues of stable and mutually beneficial cooperation with Russian and Asian partners;
- Harmonious development of customs administration;
- Development of transport international corridors and logistics projects [5].

The Latvian transport corridor is formed by 10 ports connected by TEN-T (Trans-European Transport Network) — a web of highways and railroads, alongside two oil pipelines and one major pipeline to Ventspils. Transit cargo amounts to 89 % of total shipment load in the ports. Currently out of every 7.8 euros made on export 1.4 is brought by transport services and about 80 % of all Latvian shipment load is delivered to Russia.

This sector of economy is dominated by major enterprises in some districts. The state enterprise *Latvijas Dzelzceļš* and its subsidiary *LDZ Cargo Ltd* commands railroad transportation; the Riga and Ventspils ports lead the port business; *Baltic Logistic Solutions Ltd.* dictates the road shipment; *Ventspils Nafta termināls Ltd* is with stevedoring services; the *Riga* airport is engaged in civil air transportation.

At the same time small and the smallest enterprises find their spot in this industry. There are three minor ports in Latvia, whose cargo turnover accounts for about 1 % of the total cargo volume of all the other ports. Minor stevedoring companies are quite efficient. Some enterprises are successful on the market with as few as 3—10 trucks of auto-cargo to deliver.

Riga international airport has become an important air-hub in the Baltic States, and it shows growing potential on the Northern European scale. In 2010, 82 final destinations could be reached from Riga airport, the flights provided by 19 airline companies. 4.7 million passengers travelled through the airport in 2010 (+14.7 %). The first half of 2011 saw 34.45 million tons of cargo turnover in Latvian ports, which was an 11.5 % rise to 2010, ac-

According to Central Statistics Agency. The first half of 2011 Latvian ports loaded and shipped 31,07 million tons which was 8.8 % more than during the same period in 2010 [6].

Competition in transport business in Latvia is far from fair. In this highly politicized area growth is hampered by the lack of a defined strategy and governmental support. According to experts, transit from Russia to EU countries and back could become a crucial driver for Latvian economy. All the best prerequisites for this are there, however the future of transit is forecast with caution rather than optimism.

According to an opinion poll conducted by the Center of public opinion research *Latvijas fakti*, 52 % of all the representatives of this sector deem Latvian transit developing, while 36 % think it stagnates and 12 % suppose that it is dying. The latter opinion is shared by those who specialize in automobile and sea shipment. Nevertheless, 76 % of respondents hope for an increase in transit volume in future. Such optimism can be attached to Latvia's favourable location; its well-developed infrastructure; the ability to communicate with Russian partners in Russian and to understand what is going on in the neighbouring country. All these factors have a potential to boost the sector's development. Unfortunately, there are many obstacles on the way. The major ones are the lack of a unified state transit strategy (78 % of respondents are certain about this), excessive politization of business, a complicated legislation and tense relations with Russia. Apart from that, there are some traditional pitfalls — poor roads and low capacity of Latvian-Russian border [4].

Since 1997, representatives of Latvian transit have been expecting Russia to join the WTO. For all that time Russia was sticking to discriminative railroad tariff policies. It could be partly explained by the Latvian government's attitudes towards Russia. A greater amount of cargo was shipped from Latvia to Tallinn and Klaipeda (Lithuania), and the consequences are still visible. Russian accession to the WTO could have a positive influence on Latvian transit as well. But there is a reverse side to it. The capacities of the railroad linking Russia and Latvia are limited — almost exhausted. Cargo flows will be growing, but it would be impossible to either ship or deliver the freight. A significant share of cargo is directed via Belarus, but that route will soon be overloaded. Unfortunately, there is very little progress with high-speed railway from Moscow to Latvia, which makes Latvia refuse this vital element of boosting economy and improving living standards.

Latvian transit business was badly affected when EU extended its sanctions towards Belarus till October 31, 2013. According to the statement of the Latvian Confederation of employers, EU economic sanctions on Belarus contradict Latvian economic interest and will cost Latvia 20 million latis annually.

Among 29 Belorussian companies, blacklisted and banned from entering the EU territory, there are many with long-term Latvian partners. They used to utilize Latvian infrastructure, railroads and port terminals for oil transportation. *LLC Triple* is one of blacklisted Belorussian companies that used to transport cargo to Ventspils by railroad. Two million tons of cargo of this company made 20 million latis for Latvian economy in 2011 or 0.14 % GDP or 3.4 % of total railroad shipment volume.

In 2012, the *LLC Triple* holding delivered by railroad 350,000 tons of cargo which brought only 3.5 million latis to Latvian economy or 0.03 % GDP. Another important blacklisted business partner is the *Univest M* company — one of two major private oil exporters from Belarus.

All similar EU's economic sanctions are aimed at affecting Belorussian authorities, which are seen as violating human rights by European politicians.

The administration of the Latvian Confederation of employers deems it wrong to fear remaining in the minority in the EU regarding the “Belorussian issue”, while protecting your own economic interests. Sanctions against Belarus can bring Latvia up to 480.9 million Euros losses (336.6 million Latis). Sanctions against Belorussian oil and coal transporting enterprises will reduce the cargo volume on the railroad, constituting 57 % of the total shipment volume, 3 % of GDP and 8.1 % of Latvian budget revenue [8].

According to Belorussian statistics, in 2011 Latvia was rated 5<sup>th</sup> for the volume of total trade turnover with Belarus. The turnover was equal to US \$ 3266.6 million (3.2 times increase). Export brought 3150.8 million US dollars (3.4 times increase), import — 115,8 million US dollars (121 % increase). Latvian share in the total Belarus' export turnover was 7.8 % (3.7 % in 2010). The main export article was oil and oil products (52.1 %), dissolvers and diluters (35.2 %), non-alloy steel semi-products, wire (4.8 %), coal-tar distillation products, fertilizers, salt, timber, etc. The increase in turnover in 2010 was ensured by the deliveries of metal parts from a Zhlobin metallurgy enterprise to the Latvian *Latvijas Metalurģs*.

The whole export of metal spare parts was transferred to Latvia, and it provided for uninterrupted work of rolling press at the Liepāja works. In total, in 2011 there were 84 new delivery items worth of 72.4 million dollars, but 76 of them worth US\$ 12.6 million were suspended. Such suspension related to changes in terms for agricultural export and in international trade requirements. The efficiency of diversification turned out to be plus US\$ 59.8 million.

According to Latvian official statistics, the turnover of mutual trade in 2011 accounted for US\$ 827 million, and in comparison to 2010 it showed a 1.5 times increase. Latvian export equaled US\$ 196.1 million (104.2 % increase).

Import from Belarus could be estimated at US\$ 630.9 million and showed 1.7 times growth. Discrepancies in data on mutual trade are explained by the fact that Latvian statistical methodology is focused on internal indicators of consumption in export and import.

Without considering the export from Belarus to Latvian internal market, the volume of export of Belorussian cargo transported by Latvian enterprises to the markets of other countries valued US\$ 519.1 million in 2011 and it was 4.6 times more than in 2010 [9].

Therefore, Latvia is the major transit partner for Belarus whose territory serves as a corridor for Belorussian cargo exported by sea. In its turn, Belarus is the second most important transit business partner after Russia. In 2011 the volume of Belorussian cargo amounted to 9.4 million tons and showed 31.4 % growth to the volume of 2010. The volume of cargo delivered through Belarus to Latvia, including the cargo from Russia, Ukraine, Kazakhstan in 2011, reached 21.0 million tons and grew by 32 % compared to 2010. The total volume of Belarus — Latvia transit exceeded 33.8 million tons.

In 2011, the share of Belorussian cargo in the total volume of transit through Latvia, including ports, accounted for 21.3 %. The share of railroad transportation (including transportation through Belarus to the third parties) reached 57 % of the total volume shipped by the Latvian railroad in 2011.

Structurally, the Belorussian cargo flow in 2011 predominantly consisted of petrochemicals (6.3 million tons, 68.2 % share of the total volume); chemical cargo (1.97 million tons, 21.1 % share); metals; ferro-alloys and timber.

Considering the average tariff on transportation and processing Belorussian transit cargo in Latvian ports, the profitability of Latvian enterprises in 2011 exceeded US\$ 200 million (which was the source of US\$ 40 million tax revenues).

There are 377 joint ventures with Latvian capital in Belarus, 756 joint ventures with Belorussian capital in Latvia (which bring revenue to the Latvian budget). Investment volume from Latvia reached US\$ 119,5 million and overtook the level of 2010 (228.3 %).

The decision of the US Government to use Latvian transport system to ship civil cargo to Afghanistan testifies to a high level of infrastructural development and reliability of this transit corridor. In the first half of 2010 Latvia shipped 18, 000 containers which brought 9 million Euros to Latvian economy. Meanwhile, in the context of NATO contingent reduction, preparation is underway to ensure that the transit cargo flow from Afghanistan back to the country of origin is shipped by land and air via Riga. According to the Latvian Prime-Minister, processing this cargo flow is valuable for Latvia not only in terms of its budget, but is contributing to the common NATO cause [3].

## Conclusion

The Ministry of transport set an objective to reach gradual and stable growth in the volume of transit cargo and to raise its added value, considering at the same time the growth of container cargo and the development of logistics centers. By 2020 it is aimed to increase the volume of transit cargo to 100 million tons per year, including up to two million tons of container cargo.

Shaping a common marketing strategy will attract new cargo trains and goods from China and other Asian countries, encourage new logistics centers, ferry lines for transporting container cargo from Latvian ports and will result in a substantial growth in added value of both cargo and services.

Latvia and the CIS are connected by a single railroad system (1,520 mm track), which opens the prospect to attract cargo from Middle Asia and China. As early as 2009, a permanent container train *Baltika-Tranzit* was launched between the Baltic Sea region and Central Asia. Currently, this route is being stretched to China.

In the north (Tallinn — Riga — Minsk), since 2009 there has been a container train ZUBR; there are prospects of extending the route as far as the Ukrainian ports.

In the west, the sector hopes to see changes after the strategic aim of integrating into Trans-European Multimodal transport system has been reached.

A combination of mutual transport, sea-shipping and ferry communication opens up huge perspectives for the Baltic Sea region in future.

The Ministry of Transport declared that its priorities lie with constructing industrial and distribution park, and Latvia as the Logistics center in the region expected to offer 24h service, which means that it will open up possibilities to ship goods to the shops of Helsinki, Stockholm, Minsk, Warsaw or Moscow around the clock.

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